The effectiveness of corporate governance and it's role in foreign investment decisions : evidence from Taiwan

Lien, Yung-Chih

THE EFFECTIVENESS OF CORPORATE GOVERNANCE AND IT'S ROLE IN FOREIGN INVESTMENT DECISIONS.

~~Corporate Governance, Performance and Foreign Investment Decisions:~~ Evidence from Taiwan

By Yung-Chih, Lien

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The Management Centre

King's College London

Franklin-Wilkins Building, 150 Stamford Street

London SE1 9NN

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Abstract

This thesis studies the corporate governance features of publicly-traded, family-controlled companies and the impact these have on firm performance and foreign investment decisions. Although family control and public listing seem to conflict, they co-exist in many East-Asian countries, including Taiwan. Given this phenomenon within Asia, traditional corporate governance theory, based on the Principal-Agent relationship seems out of context.

Based on the system prevalent in the West, previous research has advocated that controlling families tend to abuse their position within firms, and this thesis confirms this view. However, the thesis also reveals that the resources provided by the controlling family are crucial for corporate development, particularly in a developing country such as Taiwan. Moreover, this thesis supports the view that institutional investors are effective in restraining the controlling family from appropriating the benefits due to minority shareholders.

In addition, this thesis extends the discussion of corporate governance in an international context and tests how this impacts on strategic decisions relating to foreign investment. Results show that the financial resources provided by the controlling family are critical in the firm's decision to undertake foreign expansion. However, when the family dominates the managerial board, the firm may act rather conservatively with respect to international expansion, although domestic and foreign financial institutional investors have the opposite effect.

Finally, in the location choice for foreign investment, the thesis finds that the controlling family consistently plays a significant role in the decision to develop a portfolio of locations that include both low-risk, secure and high-risk, competitive markets. However, there is also evidence that the controlling family tends to invest in locations where there are close family contacts and familiar environments. There is also a preference for investment in tax-haven countries. These tendencies can be related to the self-interested motive of families to entrench the benefits of control, and to facilitate the intergenerational transfer of family wealth. Conversely, institutional investors have a limited ability to affect decisions related to location choice.

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This thesis would not have been possible for me without the consistent support of my supervisor, Dr. Jenifer Piesse. I would like to express my immense gratitude for her unfailing encouragement and trust in me throughout my PhD study. It has been immeasurable for me to conduct the research under such helpful and efficient supervision. I will always be proud of being one of her students.

Further, I am grateful to Mr. Roger Strange. His help and advice enabled this study to test corporate governance effects on the internationalisation strategies. To conduct the analysis on this relationship was one of my fundamental interests and it was an ambition to include this in the study, but my understanding of the various methodologies is due entirely to him.

I would also like to thank Professor Igor Filatotchev. He was my second supervisor when I was in Birkbeck College, prior to my transfer to King's. At that time, he helped me to clarify the research structure and form the foundations of this study. Although he left for Bradford University in 2002, he maintained his interest in my research and generously provided insightful comments helping me to polish the findings and formulate the arguments. During my study, I had my first conference paper accepted by the Strategy Management Society (SMS) conference, which presented in Hong Kong. This was a valuable experience for me and will be extremely useful in my future academic career. I will never forget his help on this.

Finally, and most importantly, I am deeply appreciative of my family for their endless supports during the time of my study. They may not be familiar with my research, but their love and trust were vital for me to make this happen.

Claims to Originality

Except where stated, the work presented in this thesis is entirely my own and no part of it has been knowingly submitted for candidature for a degree elsewhere. This thesis was written using "Microsoft Word" software for the text, "Excel" for the database, "SPSS" and "Limdep" for the econometric analysis.

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Introduction

This study investigates elements of corporate governance, with particular reference to listed companies in Taiwan. Thus far, the theoretical framework for the vast majority of corporate governance research is underpinned by the Berle and Means model (1932) and examines the problems that may arise from the separation of firm ownership and control. In contrast, the system of corporate governance in Taiwan is characterised by the fact that most public trading companies are under the control of one family that collectively owns the largest number of shares. Thus, this thesis considers the role of corporate governance in an environment where there is an established system of family control.

The influence of families in listed firms is a common phenomenon in most developing and emerging countries and several developed countries. In comparison with a structure where share ownership is widely dispersed, family controlled businesses present a specific set of challenges when dealing with disputes that arise between the major shareholder and outside owners. This thesis aims to study this principal-principal relationship in companies listed on the Taiwan Stock Exchange (TSE), and to discuss the effectiveness of specific governance mechanisms in reconciling the interests of all shareholder groups.

Prior to this thesis, some research has examines the nature of corporate governance in East Asia, of which Taiwan is part. However, before the financial crisis of 1997, most of these studies were based on case-study methods, and focused on the governance system that existed within a particular business group. After the crisis, attention has turned to examining whether governance characteristics can explain the economic downturn prior to the crisis, or at least the vulnerability of firms in the region (for example: Johnson et al, 2000; Mitton, 2002). However, these studies adopt a single model of corporate governance in East Asia, and use pooled data from a number of countries in the region. But the likelihood of a single corporate governance model being appropriate is small, since there are significant differences

between these countries in terms of culture, business custom and practice and economic development. In order to avoid confusing the different characteristics of countries in East Asia, this is a single country study. Taiwan is a good example of an East Asian country with high levels of family control within listed companies and which, while not totally unscathed, did not suffer unduly from the 1997 crisis.

Apart from a central focus on corporate governance and the resulting impact on firm performance, two other related issues are addressed: the decision outcomes of internationalisation strategies and FDI location choice. This is a unique feature of the research. Taiwan relies heavily on overseas markets. Increasing numbers of firms have engaged in foreign investment and transferred a proportion of business activity to overseas. It is therefore interesting to examine how the models of governance that exist in family-controlled firms accommodate expansion strategies, particularly when these are cross-border.

To examine the role of corporate governance on the decision process is useful as a way of identifying the causal relationships between strategy and internationalisation. A number of papers have studied the effects of various models of corporate governance on specific strategy outcomes, such as anti-takeover activity and corporate diversification, although the link to FDI has not received a great deal of attention. To link the fields of corporate governance and international business and explore possible relationships between them is the main contribution of this thesis.

Research Objectives

Governance-Performance Relationship

The first section of the thesis examines the characteristics of the system of corporate governance in Taiwan, particularly the factors relevant to family control, and their effects on firm performance. There are a number of studies of family control many of which are

concerned with how this can lead to abuse of managerial power, although these do not generally provide direct evidence in support of such an argument. Furthermore, a series of financial scandals in recent years have revealed that many professional managers in western firms have performed poorly, and in some cases, violated positions of trust and been prosecuted in the courts. Thus, it is not necessarily the case that replacing controlling families by professionals is a guarantee of enhanced efficiency. In fact, the experience in East Asia supports the view that controlling families play a critical role in providing a foundation for corporate competitiveness, and thus it would be rash to conclude that this system is necessary inappropriate and not part of a model of good corporate governance.

The governance effect that arises from a controlling family and the subsequent impact on firm performance is the first research objective of this thesis. With a pyramid shareholding structure, the family in East Asia does not necessarily need to hold a great proportion of shares to achieve efficient corporate control (Claessens et al., 2000). This may lead to a the separation of the interests of corporate controllers from the motive of maximising the value of the firm and highlight the potential agency problems. On the other hand, many companies in developing countries in East Asia have difficulty accessing external finance, and therefore depend on internal resources to fund development. Within the context of Taiwan, this study examines how the controlling family reconciles the potential of the abuse of managerial power with the aim of promoting firm growth, and considers how this model compares with the system of professional managers in western businesses.

An additional factor is that, in recent years, the financial markets in Taiwan have undergone considerable liberalisation to encourage the participation of both domestic and foreign institutional investors. Despite the relatively short history of the Taiwan Stock Exchange, the professional expertise and neutral position of such investors places them in an excellent position to counter the activities of the controlling family. This group will be seen as important in the empirical chapters of the thesis.

The Role of Corporate Governance in FDI Decisions

The second part of this thesis explores the role of corporate governance in the internationalisation process of Taiwanese firms, particularly with reference to two aspects of the foreign investment decision. First, the research tests the role of corporate governance variables in the decision to invest overseas activities. To reveal the multiple roles of corporate governance in the investment decision, three models measuring different forms of decision outcomes are introduced:

- whether or not the company has engaged in foreign investment
- the extent of that investment. This is measured by the cumulative number of foreign investment projects and distinguishes various levels of internationalisation for these firms. The higher the total number of foreign investment projects, the higher the level of internationalisation in the firm.
- the capital commitment to foreign investment. This is measured by the ratio of the cumulative value of investment as a proportion of total issued capital. This is designed to capture the importance of foreign investment activity for the firm, and to reflect the willingness of senior managers to accept the risks of uncertainty that arise from international competition.

The second aspect of the foreign invest decision relates to the spatial distribution of corporate foreign investments. This part of the thesis focuses on how the firm-specific features of corporate governance impact upon the decision outcome.

The Structure of the Thesis

The thesis consists of eight chapters plus a conclusion. Chapter one provides the contextual foundation of the research. The economic and cultural context is important and this chapter discusses the history of Taiwan's economic development, its commercial and business

customs, its financial markets and its growing international economic performance.

Chapter two introduces the institutional setting in which corporate governance in Taiwan exists, which is elemental to this study. The governance characteristics of Taiwanese firms reflect the particular institutional environment of the country. Thus, it is necessary to understand the local institutional system before the research hypotheses can be formulated and the analysis conducted. Chapter three describes the data and methodology. This includes an explanation of sample selection, the collection of data from public sources, and the construction of the variables. It also outlines the models used in the econometric estimation.

These are followed by a review of the relevant literature, which is divided into two chapters. The first focuses on theoretical approaches to corporate governance, and the second on international business and internationalisation studies. These include numerous empirical studies that examine the efficiency of particular governance mechanisms, and thus link the governance characteristics to specific strategic decisions of firms. These two chapters form the theoretical foundation to support the research questions and methodological approach.

Chapters 6, 7 and 8 are the main empirical chapters. Chapter 6 discusses the performance determinants, including corporate governance factors, in firms with family ownership and control. Chapter 7 tests the role of the corporate governance factors in the FDI decision, and Chapter 8 examines the role of the corporate governance factors in the spatial decisions related to FDI. These latter two chapters empirically link corporate governance factors with multinational strategy, and thus advance the discussion to an international dimension. This is a crucial feature and the major contribution of the thesis.

Chapter One: Context of the Study

Introduction

Despite its relatively small population, scarce natural resources and limited geographical area, Taiwan has become a model for newly emerging economies. Its high level of economic development could never have been foreseen 50 years ago, when the local infrastructure was seriously damaged in WWII and hyperinflation resulted from civil war with China. By the mid 1980s, the average GAP growth rate was approximately 7.3%, and nominal per capita GNP had risen to US$6,000 (Statistical Year Book of the Republic of China, 1990). Moreover, according to the government statistics of the Customs Directorate (Trading Statistical Reports, December, 1990), Taiwan had become the 13th largest trading nation in the world by the end of the 1980s,. A shift in emphasis during the 1990s changed the focus of production in Taiwan from a so-called toy products nation to one that was on the frontier of information technology, ranking third in the world after the US and Japan. The Ministry of Economic Affairs has reported that, for every 2.5 notebook computers in existence, one was made in Taiwan. Clearly, Taiwan is one of the major successes with respect to economic development.

However, despite the prosperity, there were signs of localized inflation. Between 1986 and 1991, property prices in Taiwan rose by 300%, increasing the level of inequality between rich and poor. At the same time, surplus capital from trading and property appreciation rushed into the immature, less-regulated local market, encouraging short-term opportunistic behavior by both investors and corporate managers. Speculative trading only emphasizes short-term returns without considering the underlying fundamentals, allowing companies to attract finance easily from the market and expand as much as they can. Inevitably, this sometime reckless expansion can result in failure and an over-dependence on financial leverage that can cause serious loss of wealth for minority investors. Much of the

opportunistic behavior by managers in recent years has been related to foreign investment. According to media reports (BBC, 6th/November/2002) some corporate controllers in Taiwan secretly transferred assets to overseas areas to engage in private investment, particular in mainland China and some tax haven countries. Then, after these assets have been successfully transferred overseas, these companies would declare bankruptcy in Taiwan with little regard to the interests of minority shareholders and their liabilities to local banks. There is thus considerable evidence that a more robust system of governance is necessary in the areas of corporate management, equity trade and foreign investment if the Taiwanese successful story is to continue.

This chapter provides a review of the context for the thesis. The first section summarise the general economic situation in Taiwan, including the historical background to economic development, and the establishment of the current industrial structure. The following section summarises the organisation and commercial environment of Taiwan. The third section focuses on the financial markets, and in particular, the role of institutional investors as this is especially relevant in the empirical chapters. Finally, the internationalisation of Taiwanese firms will be discussed, including sections on trade and foreign investment.

The Economic Situation of Taiwan

The Economic History of Taiwan prior to WWII

Until the late 15th century, Taiwan was undeveloped and, except for the aboriginal populations, only Chinese and Japanese pirates inhabited the south-west coast of the island. At this time, the anarchical status of Taiwan was largely due to the isolation policy of the Chinese Empire against pirates (Lee and Liu, 1998), which had prohibited all kinds of emigration from China to Taiwan since 1387. The Chinese Empire was confined to a single continent and there was no tradition or interest in governing a small and unimportant off-shore island that would

depend heavily on the mainland and only cause a burden to the coastal provinces. Thus, China neglected any serious consideration of Taiwan until the very end of the 19th century when there was an increased interest in expanding colonial ambitions, although the Empire had official ruled the island since 1684.

But Taiwan had been a focus of international attention since 16th century. In 1583, a Portuguese vessel sighted Taiwan and named the island Formosa and, in 1626, a Spanish vessel landed on Taiwan. Following their successful colonisation of the Philippines, the Spanish were determined to increase their presence in the region, hoisting the flag of Castile over the port of Keelung in north Taiwan, naming it San Salvador, and three years later, established the port of San Domingo in the northeast (Du, 2002). At that time, the Portuguese were attempting to monopolise trade with China from their base at Macao and both Spanish and Dutch traders were expanding trade links with Japan. Furthermore, the Dutch did not want to further lag behind in the contest for trade in the Far East (Song and Shi, 2003). To compete with their Spanish and Portuguese rivals, the Dutch were determined to secure an island in the region, and Taiwan was the target.

In 1624, the Dutch occupied Taiwan, established a capital on the south coast and, fifteen years later, expelled the Spanish and took control of the island. Labour was imported from China. The number of Chinese inhabitants rose from a starting level of 25,000 to 100,000 by 1650 (Heyns, 2002). The Dutch introduced ranching practices from the East Indies and cultivation of sugar cane. During the Dutch occupation (1624 to 1662), the Dutch East India Company administered most sections of the island.

Strategically, the primary reason for Dutch settlement in Taiwan was to serve as operational base to conduct trade between Mainland China, Japan and the Dutch East Indies - principally Java (Cheng, 1996). In particular, silk cloth, raw silk, gold and ceramics were imported from China and then exported to Japan, the East Indies and Holland. Similarly, spices, pepper, linen, cotton and opium were imported from the East Indies and then exported

to Japan and China. Moreover, deer products (such as hides, meat and horn) sugar and rice of Taiwan were exported to Japan, China and even Persia. At the same time, trade between the Dutch and the local residents increased steadily. The Dutch considered their possession of Taiwan as a highly successful venture.

However, events in China were to seal the destiny of the Dutch adventure in Taiwan. In 1662, the old Chinese Empire was overturned by the Manchu from the north, resulting in a mass exodus overseas. One leader of this group, named Cheng Cheng-kung, but known in the west as Koxinga, left for Taiwan and ended Dutch control on the island. Koxinga was the son of a pirate leader, based in Taiwan before the Dutch administration, and together they owned the finest fleet in the East Asian area. They controlled much of China's trade, and the family was extremely rich and powerful (Xia and Zhang, 1992). Koxinga brought a large number of scholars and religious officials, as well as their dependents, to Taiwan and Chinese culture became established on the island. After Koxinga defeated the Dutch, immigration from China to Taiwan accelerated markedly despite the policy by the new Chinese Empire to isolate Koxinga from the mainland (Cao, 1961). The new Chinese immigrants developed agriculture, and brought skilled farmers from China to exploit the island. The increasing amount of cultivated land allowed the island to become self-sufficient in food and, despite the loss of trade with China, the local economy of Taiwan flourished.

In 1684, the Chinese Empire successfully took over Taiwan from Koxinga's grandson. From then until 1886, Taiwan was a prefecture of Fujian province, just across the Taiwan Straits. However, despite several attempts to prevent sedition against the central government, Taiwan was largely ungoverned during this time. In order to reduce the governance cost on the island, immigration to Taiwan was prohibited, although this continued illegally (Chen, 1990; Xu, 1988). According to Japanese estimates, the Chinese population in Taiwan at the beginning of the 19th century was two million, concentrated in the western coastal plains (Lee and Liu, 1998). Taiwanese commerce during this period relied almost exclusively on

agriculture. In order to finance and develop agricultural production on Taiwan, a land tenure system was developed in which wealthy Chinese investors provided capital and protection from hostile aborigines to settlers who cleared and farmed the land in return for a perpetual lease payment of a fixed amount (Chen, 1995). This system of ownership acquired another level as the original settlers in turn subleased all or part of their land to subtenants. The result was a three-tiered land tenure system that included cultivators, tenant cultivators and landlords.

However, the Western powers had not given up and again turned their attention to Taiwan in the 19th century. During the 1839-42 Opium Wars between China and Britain, British ships attacked Taiwan. The trade ban imposed by China since 1387 was repealed and Taiwan was again open to international trade. The great Western colonial import-export houses, such as Jardine & Matheson and Dent & Co., established subsidiaries there so as to utilize the potential of Taiwan for conducting trade in East Asia [1]. Moreover, the British Imperial Court exploited the natural resources of Taiwan. Other foreign powers targeting the island were the American Navy's Indian Ocean fleet in 1874, and the French in 1884. The French occupation suffered from the violent resistance of the local Chinese, and from the well-calculated neutrality of Britain, which prohibited the access of French vessels to ports under its controls. Paris formally renounced its claims on Taiwan in 1885.

By 1886, the Chinese Empire was finally aware of the importance of Taiwan and elevated its status to that of a province. At that time, the island had 2.5 million inhabitants (Chen, 1990). The political and commercial centre had moved from south to north Taiwan and in 1882, the prefecture of Taipei was established. As the first governor of Taiwan province, Liu Ming-Chuan launched vast projects to develop the infrastructure of the island. These included the first railway line and the first mechanical mine.

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[1] See "International Traders in Taiwan", Investigation and Research Department, Chang-Hwa Commercial Bank, Taiwan, 1972.

Once Taiwan had reopened to international trade, sugar, tea, lumber, camphor and coal were the major exports and opium, cotton and woollen goods the principal imports[2]. Finished goods were imported rather than raw materials, because Taiwan had no real manufacturing facilities at that time. Chinese traders operating junks between Taiwan and mainland China supplemented the trade conducted by Western traders (Chen, 1991). The Chinese Empire did little to modernise or diversify the Taiwanese economy, and many officials sent from Beijing were incompetent, corrupt and uninterested in improving the economic conditions (Tang, 1988). Only in the very late 19th century, did the Chinese Imperial Government attempt to improve the local infrastructure, leaving the island economically backward by world standards at the start of the 20th century.

Defeat for China in the Sino-Japanese war resulted in Taiwan being ruled by the Japanese between 1895 until the end of WWII. This half-century of Japanese occupation left profound marks on the way of life, culture, and even on the mentality of the Taiwanese. During this time, the economy of Taiwan improved considerably[3]. Most importantly, the infrastructure was enhanced and the local economy changed from subsistence agriculture to one that benefited from foreign trade with mainland Japan. Railways, roads, irrigation and flood control barriers were constructed, a police force established, electricity and a tax system were introduced. In terms of foreign trade, imports from Japan were mostly textiles, fertilisers and industrial goods, while exports from Taiwan included rice, sugar and processed food, and industrial capacity increased. Some heavy industries were created and small and medium sized industries flourished, such as shipbuilding and refining major activities. Unfortunately, during the Second World War infrastructure and industry were seriously damaged and the economy of Taiwan was in a perilous state when the island was returned to

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[2] The estimation is based on "Tables of Taiwanese Trade (1896-1948)", Statistic and Accounting Department, Taiwan Province Government, Taiwan, 1960.

[3] See "Features of Taiwanese Economy in Japanese Occupied Period", Financial Research Center, Bank of Taiwan, Taipei, 1957.

China in 1945.

The Economic History of Taiwan after WWII[4]

After the war, the disputes on mainland China between the Communists of Chairmen Mao and the Nationalists of Chiang Kai-shek again had a major impact on Taiwan. The Nationalists withdrew to Taiwan, not only leading to the de facto creation of the state of Taiwan but also altering the demographic structure: two million mainlanders followed the Nationalists to Taiwan. Unlike the previous Chinese immigrants, the origins of these people were not limited to the southern provinces but came from all over China with diverse backgrounds and skills.

The Nationalists faced an incredible challenge to establish a government in Taiwan. To resist the Communists and even to fight for the return of the mainland, military expenditure accounted for between 80 and 90% of total government expenditure through the 1950s (Liu and Wang, 1992). At the same time, the influx of refugees created a huge burden on local industrial and agricultural capacity. The original economy of Taiwan, which was structured to depend on trade with mainland China or Japan in terms of exports of agriculture, foods and imports of finished goods, collapsed and new trading partners were necessary as well as a plan for economic development[5].

Three crucial issues account for the recovery in the first phase of economic recovery and development in Taiwan (Sun, 1995). Firstly, American assistance from 1950 injected considerable capital and other resources into the island, largely to repair the war damage. Second, a series of land reforms were introduced. These had three components: rent reductions, the sale of public land and a scheme to redistribute land from landlords to tenant

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[4] The statistical data in this section is taken from the "Economical Yearbook of Republic of China", 1990 edition, Directorate General of Budget Accounting and Statistics, Executive Yuan, Central Government of Taiwan.
[5] See "Post-War Taiwanese Economy", monographs published in a series of Taiwan study, no. 4, Taiwan research center of Xia-Men University, Xia-Men, Fujian, China, 1982.

farmers. The last of these was not surprisingly controversial, but it resulted in increased productivity, with landlords compensated and encouraged to begin to develop industrial capacity (Xiong, 1989). Finally, import-substitution policies were introduced and import tariffs, import quotas and currency controls were used to increase domestic production. In particular, the government imposed strict foreign exchange control. From the mid-1950s, the domestic output of Taiwanese industries met local market demand in many products, such as textiles, bicycles and flour, with annual growth rates of GDP around 7.6% for this period.

The next major phase of economic development was between 1960 and 1986, during which time the economy shifted from one based on import-substitution to one that was more export-driven, largely based on the argument that an import-substitution strategy was impossible on the island with such a small domestic market and low per capita income (Sun, 1991). This reversal was highly successful and between 1962 and 1972, the annual rate of exporting growth was consistently greater than 30% and GDP growth of 9.1%.

With the exception of the devalued New Taiwanese Dollar (NTD) and the strict exchange control, the success of the export-driven policy can be ascribed to the government policy of providing low cost capital and tax incentives to exporters, and duty-free imports of raw materials used for further exports. Export cartels were also formed under government encouragement and the amount of imported consumer goods was constrained to save capital and foreign exchange for intermediate goods. At the time too, the native Taiwanese business community began to evolve and expand (Chen, 1998). Native Taiwanese entrepreneurs, who had been educated in Japan and were used to dealing with foreign investors, came to dominate the private sector of the economy. They had the advantage of being able to communicate with Japanese businessman, and to set up networks and alliances. The foreign cooperation between the Taiwanese and the Japanese or the Americans enhanced the local economy and resulted in increased savings, investment and trade.

To consolidate the advantages of this phase of economic development, a new plan was

launched in 1988 to make the transition from a local to a modern, developed economy and to encourage the more capital-intensive, high value-added industries (Wu, 1994). This plan included the liberalisation of many sectors and research and development expenditure on technology and innovation. Finally, in an effort to stimulate industrial performance, tariffs were reduced, import controls were lifted, and restrictions of foreign companies entering certain sectors were eliminated.

Industrial Transformation[6]

During the process of industrialisation, domestic manufacturing gradually shifts from consumer goods to capital products (Lavigne, 1995). Fifty years after the Second World War, industrialisation of the Taiwanese economy was complete and reflected in the structure of manufacturing change, measured by the proportion of consumption goods to capital goods (see Table 1.1 and Figure 1.1). For Taiwan, consumption goods include food, beverages, textiles, leather, clothes and furniture, while capital products are generally chemicals, chemical materials, metal and metal materials, machines, transport and plastics.

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[6] For reference see: Kuznets, S., "Growth and Structural Shifts", *Economic Growth and Structural Change in Taiwan: the Postwar Experience of the Republic of China*, Galenson Walter eds, Cornell University Press, 1979.

Table 1.1. The Production of Consumption Goods and Capital Goods, Taiwan, 1971-95

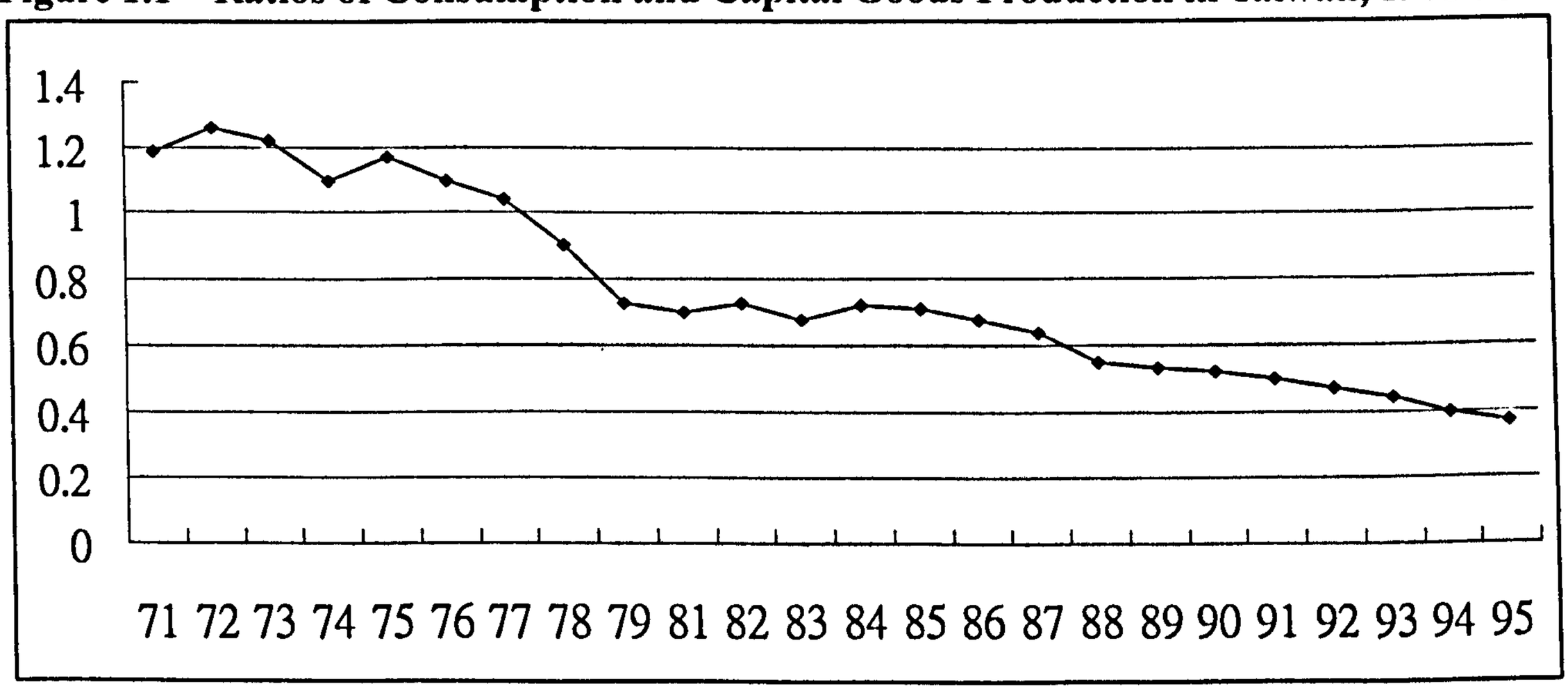
Year	Consumption Goods	Capital Goods	Ratio	Year	Consumption Goods	Capital Goods	Ratio
1971	72457	60703	1.19	84	923145	1285239	0.72
72	97065	76828	1.26	85	928240	1301168	0.71
73	129592	106166	1.22	86	992791	1454760	0.68
74	157371	142837	1.1	87	1043573	1623359	0.64
75	174799	149324	1.17	88	1006010	1837782	0.55
76	216719	196612	1.1	89	1043898	1973545	0.53
77	249013	239588	1.04	90	1032263	1980960	0.52
78	290417	324302	0.9	91	1110362	2201009	0.5
79	319562	436940	0.73	92	1063031	2257127	0.47
81	723678	1027626	0.7	93	1024445	2352452	0.44
82	731054	1005256	0.73	94	1059383	2618483	0.4
83	780327	1141506	0.68	95	1073959	2940716	0.37

(Unit: Million NT$)

Note: Consumption goods include food, beverages, textiles, leather, clothes and furniture; Capital goods include chemicals, chemical materials, metal, metal materials, machines, transport and plastics; Ratio is consumptive products value to capital products value.

Source: Taiwan Statistical Data Book, 1996, Council for Economic Planning and Development, Executive Yuan, Central Government of Taiwan.

Figure 1.1 Ratios of Consumption and Capital Goods Production in Taiwan, 1971-95



Note: Horizontal axis indicates specific year 1971-95; Vertical axis indicates the annual ratio of output value between consumption goods and capital goods in Taiwan.

Source: Table 1.1

As shown in Table 1.1, the ratio of the value of output of consumption goods to capital goods fell from 1.19 in 1971 to 0.37 in 1995. The improvement is even more evident in Figure 1.1 as the speed of the downturn accelerates from 1975 to 1980, indicating that this

period was decisive in the transition of the economy.

The Nature of Commercial Customs in Taiwan

A number of aspects of Taiwanese business practice reflect culture, tradition and the importance of family and religion, some of which will explored in the following sections.

Confucianism and Guanxi

While not technically a religion, Confucianism has both consciously and unconsciously influenced the attitude and behavior of the business community in most Chinese-based societies including Taiwan (Huang, 2000). Confucianism developed from a set of ethical rules taught by Confucius and defines a moral and ethical code that is appropriate to maintain a relationship with others. This classifies human relationships into the five categories and accordingly sets the principles to harmonise these relationships. Confucianism teaches that each person has a place in a hierarchical society and the preservation of this hierarchical order is of paramount importance for social harmony. Within this Confucian society, relationships between members are mostly vertical rather than horizontal.

Confucianism has been adopted for over two thousand years in mainland China, but has spread though emigration and general communication between countries and is now popular in many neighbouring countries such as Japan, Korea and South-East Asia. Although this closed and rigid structure of hierarchies can restrain individuality, other ethics such as the stress on societal harmony, discipline, and a respect for work, have attributed to the economic success of many Asian societies over the last century (Yeung and Tung, 1996).

The citizens in most Confucian societies, including Taiwan, emphasize and utilize personal relationships to demonstrate individual social position. Moreover, individual relationships are commonly involved in commercial activities in action. The personal relationship able to effectively interfere in the commercial consideration is usually called as

Guanxi, which is the Chinese word for relation. In Chinese style commerce, the special relationship between two people, which is referred as the Guanxi, usually allows each to demand special consideration, benefits and favours from the other (Kipins, 1997). In most cases, the strongest Guanxi exists between blood relations, followed by the relations between classmates and residents of same town or province (Fan, 2002). Particularly, the Guanxi relationship is reciprocal - each person in the relationship is obligated to offer favours to the counterpart, and meanwhile, is owned favours from the other (Hwang, 1987; Liu, 1983). Guanxi relationships have operated in Confucian societies for many centuries, and have created extensive personal networks of mutual dependence amongst local businesses, thus preserving social stability.

Guanxi can contribute to commercial success and can provide a comparative advantage to those in the network (Luo, 1997). Close ties with family, classmates and colleagues ease business and allow for special treatment to those in the group. Therefore considerable time and effort is devoted to developing such networks and these informal contacts have great importance. This is reflected by a preference for short, generally-worded agreements, as well as a proclivity to ignore agreements once they are executed. Indeed, the custom of relying on Guanxi to finalise a commercial arrangement is frequently more acceptable than aspects of the legal system in business disputes (Xin & Pearce, 1996). A Guanxi proponent explaining the attitude of the business community in Taiwanese notes that: *during the process of cultivating Guanxi within business relationships, customer loyalty evolves naturally, while bonds are created with suppliers and with creditors (Financial Times, 27/11/00).*

The Family

The family is another element at the centre of Confucianism, which has extended into commerce. To understand the impact of Chinese society on an economy like Taiwan, it is necessary to understand the primacy of the family as a social institution in traditional Chinese

culture (Leung, 1995). Although the contemporary family structure has changed considerably in recent years (for example: smaller family sizes, the disappearance of the clan structure, and even the extent to which children are influenced by school rather than by the home), several traditional aspects remain.

In common with most Confucian societies, the role of the family in Taiwan is primarily to continue the ancestral line, and this requires males to pass the family name to the next generation. It is thus the male that has the power to determine family issues (Huang, 1999). Respect for age is another core value, whether between parents and children or amongst siblings. These are both examples of hierarchical relationships between people, which help to maintain social stability and harmonisation. This is enhanced by the conception that family members are not primarily defined as an individual, but as the obligatory role of father, mother, spouse, elder brother or sister or younger brother or sister. Accordingly, the name of members of the Taiwanese family is composed of the family name first, the generation name second and the individual name last.

The importance of these aspects of culture and custom in Taiwan is central to a number of aspects of the thesis. Links between the relationships with the family are extended to the networks and hierarchies in business and will impact on the analysis that follows (Yeh, 1991). For example, a manager of a small business would compare this role to that of the family, both in the decision-making role of the head of the firm and the responsibility shown towards employees. It is clear that features such as the observance of hierarchy, the quest for harmony, and the respect for the elders have implications, one of which is the difficulty young or less experienced managers have in business organisations. Furthermore, there is a tendency to demur to senior members of the firm, regardless of the degree of competence or knowledge (Heller, 1991).

The Financial Markets in Taiwan[7]

The Taiwan Stock Exchange (TSE)

No securities transactions took place in Taiwan during the period of Japanese control, but following the reforms after WWII, privatisation and land reform created the need for establishing financing channels for firms (whether under private or public ownership), and a rudimentary market for securities trading was established. Initially, this was highly unorganised and lacked any formal legal or other institutions, until the government introduced a more orderly stock market in 1959, enhanced by an official authority, the Securities and Exchange Commission, in 1960. The Taiwan Stock Exchange Corporation (TSE), which is responsible for conducting security transactions, was founded in 1961. Since that time, the securities market in Taiwan has grown gradually and is now an established and well organised institution.

The TSE is the sole centralised securities market in Taiwan. The operational aspects have improved considerably since its establishment and the service provided to market participants has improved considerably. . The early method of trading was based on traditional out-cry methods, although this has now been completely replaced by the Automated Securities Trading System, which allows matching of transactions in a much more efficient way. There is evidence that the introduction of the new trading system has contributed greatly to the liquidity of the TSE. In addition, the Taiwan Securities Central Depository Corporation was launched in 1990 to provide the auxiliary service of central custodian for the securities trades within the TSE.

Apart from the main list, a preliminary Over-the-Counter Securities Exchange began in 1994, and provides a second financing channel for firms and also creates wider choices for investors. Furthermore, hedging instruments are traded on the Taiwan Futures Exchange

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[7] This section of discussion relies on "Fact-Book of Taiwan Stock Market, 2000" and "Annual Report of Taiwan Stock Exchange Corporation, 2000", Taiwan Stock Exchange Corporation.

established in 1997 and in 1997 the Taiwan Rating Corporation opened, which was the first credit rating agency on the island. Other institutions to support the business sector are numerous banks, securities firms, insurance companies, investment funds or project financing corporations that are able to participate in the markets and provide independent assessments of firms trading on the exchange.

While considerable progress has been made, the TSE is still at a developmental stage. Compared with global financial markets, the TSE is still a long way from the frontier in terms of transactions efficiency or market scale. Apart from its relatively short history, the market has been constrained by a number of factors. The most important of these is that many Taiwanese companies are still largely under family control, and this controlling family tends to be reluctant to sell shares to outsiders, since doing so could result in a loss of control over both management and finances. Moreover, Taiwanese companies customarily consider management as a family issue that can be solved within the members of controlling family, and are disinclined to either comply with disclosure requirements associated with a public listing or to pay dividends to shareholders. Furthermore, there is a widespread belief that the stock market in Taiwan is dominated by speculators, who have access to inside information, and are able to use this to take advantage of normal investors, thus causing price fluctuations and overall volatility. Given this high uncertainty about share prices, most investors view the stock market as a place to reap short-term speculative profits from price swings. This exacerbates market instability and harms investor confidence. Finally, the relatively brief history of the TSE means that there is a shortage of experienced brokers and managers. Thus, for the average investor, knowledge of the operational aspects of the financial markets is limited and there is a general wariness about taking an individual decision, leading to high levels of communal, or herd behaviour, none of which is conducive to price setting based on principles of market efficiency.

The Impact of Institutional Investors and Related Institutions

Before 1990s, shareholding by foreign institutions was forbidden. But in 1991 this restriction was removed and both domestic and foreign institutions have since operated on the TSE. However, prior to active trading, foreign institutional investors require permission from the Security & Futures Commission and the Central Bank in the form of a Qualified Foreign Institutional Investors (QFII) certificate[8].

However, in order to prevent potential conflicts of interest, the Security & Exchange Law prohibited institutional investors from simultaneously operating any business relating to security transactions. In a relative small and nascent financial market like the TSE, institutional investors were limited to constructing efficient investment portfolios, simply to diversify risk. Therefore, most security institutions in Taiwan would prefer to be a broker rather than to invest directly in the market. Since 1988, this constraint has been removed, making it is possible for an institutional investor to perform multiple roles, such as those of underwriter, dealer, broker, investment-trust manager and investment consultant. In addition, domestic institutional investors have been allowed to issue their own securities. This encourages the security institutions to act as efficient and proactive investors in the market. The result of this liberalisation is that the market value of these publicly-listed security firms is not solely dependent on their brokerage business, but also on their profits from investment activity.

Given the level of development of the financial markets in Taiwan, the participation of banks may be useful as an efficient source of market discipline. The 1988 revision in the Security & Exchange Law allows banks to function as institutional investors and also brokers. Before that, all banking institutions in Taiwan were banned from any form of investment in the capital markets in order to maintain their neutrality and protect the interests of general

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[8] The trading constraint of QFII certificate toward foreign institutions has been further canceled since 4th/October/2003.

depositors.. The series of reform that liberalised banking activity and provided them with the opportunity to investment in securities, has strengthened the confidence of individual investors with regard to accountability and transparency and improve the efficiency of the capital market.

The Development of Securities Business

Table 1.2 shows the growth in securities between 1989 and 2000. It is clear that after financial sector deregulation, securities firms diversified into a number of different areas of business. The number of brokers declined steadily, while the number of dealers and investment-trust firms increased, revealing a clear shift from a single capacity system to the much broader model of institutional investor. At the same time, the market is becoming more concentrated, with fewer large firms and more subsidiaries. This is a period of general reorganisation and the increased internationalisation of the TSE has resulted in a much greater level of competition between foreign and domestic institutions, although there are differences in the direction of their respective businesses. Most of the foreign institutions are interested in Taiwan as an investment opportunity in a newly-emerging market, and domestic firms have consolidated through mergers and acquisitions in order to be able to compete with the large-scale international investment organisations.

Table 1.2. Securities Firms in Taiwan, 1989 - 2000

Year	No. of Securities Firms		Brokers	Dealer	Underwriter	Investment Trusts	Investment Consultant
	Headquarters	Branches					
1989	259	28	250	31	41	4	50
1990	381	30	371	37	60	4	73
1991	353	74	340	55	61	4	80
1992	294	133	277	68	59	15	78
1993	272	189	254	68	57	15	87
1994	262	235	245	72	57	15	95
1995	247	320	232	72	55	15	102
1996	229	420	212	79	58	19	115
1997	221	663	199	95	71	24	147
1998	215	911	188	108	81	29	196
1999	212	987	184	112	84	36	219
2000	190	1092*	158	105	75	38**	238

Source: Important Market Indicators of TSE, December / 2000, Security & Future Commission, Ministry of Finance, Executive Yuan, Taiwan.

* At the end of 2000, there were 13 foreign securities branches and 4 foreign representative offices.

**At the end of 2000, there were 38 investment trust companies, which had issued 301 mutual funds in total.

The Weak Market Position of Institutional Investors in the TSE

According to the statistics of the market regulator (Security and Future Commission SFC), institutional investors are not the major source of capital on the TSE. This is contrary to most capital markets in developed countries where the institutional investors are the dominant form of capital provision. Between 1996 and 2000, individual investors were consistently the major providers of capital (see Table 1.3), with the institutional investors second. Note that the institutional investors included in the table are a combination of government agencies, domestic and foreign financial institutions and domestic and foreign firms.

Table 1.3. Capital Source Analysis by Listed Companies in TSE from 1996 to 2000

Year	Individual Investors	Institutional Investors*	Investment Funds
1996	57.96%	37.90%	4.14%
1997	57.76%	38.25%	3.99%
1998	59.65%	37.59%	2.76%
1999	59.01%	37.53%	3.46%
2000	56.13%	39.96%	3.91%

Source: Taiwan Stock Exchange Statistical Data 2001, Taiwan Stock Exchange Corporation.

* The institutional investor includes government agencies, domestic financial institutions, foreign financial institutions, domestic corporations and foreign corporations.

Viewed by the value of market trading in Table 1.4, the weak presence of the institutional investor in the TSE is even more conspicuous. Despite a capital contribution of almost 40%, their total trading amounted to a maximum of 14% throughout the 1990s. The reason for the difference may also be related to the incentive for long-term investment that consolidates the controlling structure for a particular firm.

Table 1.4. Investors Composition by Trading Value on TSE 1991 – 2000

Year	Institutional Investors				Individual Investors		
	Domestic		Foreign		Domestic		Foreign
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount
1991	620.6	3	11	0.1	19,829.00	96.9	1.08
1992	452.7	3.6	31.6	0.1	11,953.80	96.1	1.14
1993	993.2	5.4	89.7	0.5	17,415.10	94.1	1.68
1994	2,261.00	5.8	264.5	0.7	36,415.20	93.5	3.32
1995	1,378.30	6.7	284	1.4	18,940.00	91.9	2.61
1996	2,265.40	8.6	556.7	2.1	23,445.20	89.3	2.67
1997	5,694.90	7.6	1,289.00	1.7	68,428.20	90.7	10.85
1998	5,144.30	8.6	964.8	1.6	53,480.50	89.7	9.08
1999	5,520.50	9.4	1,420.10	2.4	52,043.20	88.2	8.11
2000	6,306.50	10.3	2,222.20	3.6	52,855.30	86.1	5.7

(Unit: Billion NT$)
Source: Important Market Indicators of TSE, December / 2000, Security & Future Commission, Ministry of Finance, Executive Yuan, Taiwan.

Growth of Institutional Investors

As shown in table 1.4, while the trading volume of institutional investors in the TSE is relatively low compared with the figures for individual investors, there is a clear growth trend during the 1990s. Furthermore, this trend is not only reflected in trading values, but is also in the higher share of institutional trade in total. Although the financial crisis of 1997-1998 had some impact, both domestic and foreign institutional investment recovered quickly and continued to grow. It appears that although making a late entry to the Taiwan markets, foreign institutional investors have been highly active in the Taiwan market. From 1991 to 2000, the percentage of foreign institutional investment in the total trading amount of TSE has

increased from 0.1% to 3.6%. Domestic institutional investors also grew rapidly during this time, increasing from 3% of total trading in 1991 to 10.3% in 2000, in this case largely following deregulation and the move to multiple operations.

The Investment Strategies of Domestic and Foreign Institutions

Within the general category of institutional investor, domestic and foreign firms differ in their investment strategy. Foreign institutions are more concerned with the fundamentals of target equities, whilst domestic investors concentrate on technical analysis to guide investment decisions. Often there are conflicting results. Business Weekly (28, Aug, 2001), a local Taiwanese business newspaper, reported that domestic and foreign institutional investors reacted adversely towards the merger between Acer and Sertek, two listed companies on the TSE. Before the merger, these two companies were closely associated although operating in different product markets. Sertek was the electronics section of Acer but became independent in 1976. Since then, Acer had been the biggest shareholder of Sertek, holding over 30% of the shares in the first quarter of 2000. After the merger announcement, most domestic institutional investors reacted positively toward the issue and bought shares in the new, combined company Acer. In contrast, most foreign institutional investors reacted negatively toward the merger and sold their holdings of Acer. The view of market analysts of the negative attitude of foreign institutions to this merger was that they could not see the opportunity to achieve fundamental improvements for both companies since they were in different market sectors, they already had a close relationship for a long time and no additional synergies were expected.

The Investment Strategies of Institutional and Individual Investors

Despite the relatively ineffectual role of institutional investors in Taiwan, in terms of both volume and participation levels, they still have some influence on individual investments and

in determining market prices. Chang et al (2000) studied herd behaviour in the equity markets of five countries including Taiwan. Based on data from January 1976 to December 1995, they found that the participants in the Taiwan stock market behaved remarkably similarly with respect to their investment decisions. This study covered a period prior to liberalisation and the opening-up to the international community, and investment patterns were common to both groups. In addition, macroeconomic conditions, rather than firm-specific information, tended to have a more significant impact on investor behaviour. This suggests that, while individual investors are the major source of capital, decisions are not purely made on firm-level information. Rather, investors rely on general awareness of the economy that is not purely rational, but could be explained by the prevalence, common in newly emerging markets, of asymmetric information. Even though individuals have resources and a willingness to invest, they do not feel confident about the level of information available for individual firms.

All these features of the Taiwan stock market provide a favourable environment for institutional investors, which are better able to overcome the information asymmetries and make the most profitable investments. Furthermore, the superior abilities of institutional investors lead individuals to follow and therefore institutional investors are able to influence the trading decisions of individuals leading to a continuation of the herd behaviour found earlier.

The Future of Institutional Investors in Taiwan

At the moment, institutional investors are not major players in the Taiwan capital markets but signs indicate this will change in the future. With increasing levels of international expansion in Taiwanese companies, managers will be keen to attract the attention of the financial institutions as a source of funding, especially those able to raise foreign capital. Oxelheim et al. (2001) have argued that gaining and maintaining a global presence and the

availability to raise foreign capital is one of the most important factors in corporate international expansion. Companies are more likely to engage in foreign investment when it has retained one of the prominent international financial institutions as its advisor. For Taiwanese firms, the support and recommendation of international investing institutions is the best way to bridge the gap between themselves and global capital.

However, in order to attract foreign investment, Taiwanese companies may need to switch from their traditional way of conducting business to a more transparent approach. It has been reported (Business Weekly, 20, March, 2002) that the chairman of a leading electronics company in Taiwan, a stereotypical older-generation entrepreneur, rigid, strict and reluctance to communicate, attended a conference in Hong Kong and made a speech in English for first time in his life. This individual was famous for his rigid attitude towards investors, and had even declared publicly that his company could survive without external finance. However, the purpose of the Hong Kong trip was reportedly explicitly to attract investment from foreign institutional investors for his latest expansion project. The report commented that it would be difficult in the current climate for any company to compete internationally without a global capital source, and personal contact between corporate chairman and investors was essential to earn the trust of foreign institutional investor.

Internationalisation of Taiwanese Firms

International Trade[9]

Given its small geographical area, relatively high population and scarce resources, Taiwan is highly trade-dependent, especially with mainland China, Japan and the US. Fortunately, Taiwan is a very successful trading nation, with annual exports amounting to US$1228.7 billon and imports of US$ 1072.4 billion in 2001. Table 1.5 shows in a global ranking of

[9] Discussion in this section relies on "Annual Report of Bureau of Foreign Trade", 2001 edition, Bureau of Foreign Trade, Ministry of Economic Affairs, Executive Yuan, Taiwan.

national trading values, Taiwan was 15th in 1999, 14th in 2000 and 16th in 2001, similar to that of Singapore and Spain.

Table 1.5. The Top Twenty Trading Nations, 1999-2001

Ranking	1999		2000		2001	
	Nation	Value	Nation	Value	Nation	Value
1	US	17,615	US	20,404	US	19,100
2	Germany	10,164	Germany	10,457	Germany	10,575
3	Japan	7,277	Japan	8,587	Japan	7,528
4	France	5,974	UK	6,159	France	5,946
5	UK	5,862	France	6,100	UK	5,883
6	Italy	4,555	Canada	5,155	China	5,101
7	Canada	4,532	Italy	4,780	Canada	4,816
8	Holland	3,906	China	4,554	Italy	4,748
9	China	3,609	HK	4,147	HK	4,110
10	HK	3,534	Holland	4,064	Holland	3,910
11	Belgium	3,436	Belgium	3,649	Belgium	3,691
12	Mexico	2,784	Mexico	3,409	Mexico	3,268
13	South Korea	2,634	South Korea	3,327	South Korea	2,915
14	Spain	2,544	**Taiwan**	**2,883**	Spain	2,688
15	**Taiwan**	**2,323**	Singapore	2,724	Singapore	2,378
16	Singapore	2,257	Spain	2,662	**Taiwan**	**2,301**
17	Sweden	1,534	Malaysia	1,802	Malaysia	1,619
18	Switzerland	1,516	Sweden	1,596	Switzerland	1,552
19	Malaysia	1,500	Switzerland	1,510	Russia	1,408
20	Austria	1,337	Russsia	1,370	Sweden	1,378
	Global	**109,329**	**Global**	**122,516**	**Global**	**117,950**

(Unit: Thousand Million US$; Value = Import + Export)
Source: Statistical Tables (International Trade) - Economic Statistic Annual, 2003 edition, Ministry of Economic Affairs Executive Yuan, Taiwan.

After the separation with China following WWII, the US and Japan became the two most important trading partners of Taiwan during the1950s to 1990s. In particular, the American Generalised System of Preferences (GSP) programme in the post-War period, which granted duty reductions on imports from developing countries, was one of the main reasons for Taiwan economic policy to move from import-substitution to export-promotion in the 1960s. Since that time, Taiwan has maintained a close commercial relationship with America, and trade is heavily reliant on the American market. Trade with the US peaked in the late 1980s, and in 1988, Taiwan was the 5th largest trading partner of the US, acquiring a trade surplus of US$10.4 and accounting for nearly 40% of Taiwanese exports. The US have reduced their

trading deficit by urging the Taiwanese government to cut import barriers and open their domestic market, but the increasing imports from the US have further strengthened the commercial relationship.

Next to the US, Japan was the second largest trading partner prior to 2001. The strong trading relationship between Taiwan and Japan is largely due to historical and geographic reasons. Taiwanese companies have acquired sophisticated technology, industrial facilities and components, making Japan the major supplier for many firms. Compared with the trade relationship with the US, Taiwan has tended to maintain a bilateral trading deficit with Japan.

Trade with Europe had traditionally been hindered by the distances involved and by the differences in culture, and subsequently there was little trading activity for a long time. But the worrying dependence on US trade in the 1980s has led to efforts to encourage a relationship with European countries. This has been largely successful. According to the Bureau of Foreign Trade statistics, the trade values rose 63.4% from 1986 to 1987 and achieved a further 35% percent of annual growth in 1988. It is now common for European businesses to tender for large infrastructure contracts in Taiwan, such as hydroelectric equipment and transport systems, which were previously limited to US and Japan vendors. Table 1.6 reports the values of exports, imports and the trade surpluses of Taiwan with the US, Japan and the EU countries between 1997 and 2002. In terms of exports, the US continues to be the most important market, followed by the EU and then Japan, whereas the ranking changes with respect to imports.

Table 1.6. Taiwan Trade with US, Japan and EU, 1997–2002

		1997	1998	1999	2000	2001	2002
Total	Export	1,221	1,106	1,216	1,483	1,229	1,306
	Import	1,144	1,047	1,107	1,400	1,072	1,125
	Net Trade	77	59	109	83	156	181
US	Export	296	294	309	348	277	268
	Import	232	197	197	251	182	181
	Net Trade	63	97	112	97	94	87
Japan	Export	117	93	119	166	128	120
	Import	290	270	306	386	258	273
	Net Trade	-173	-177	-187	-220	-131	-153
EU	Export	172	185	191	222	184	169
	Import	179	176	144	155	128	120
	Net Trade	-7	8	46	67	55	49

(Unit: Thousand Million US$)
Sources: Statistical Tables (International Trade) - Economic Statistic Annual, 2003, Ministry of Economic Affairs and International Trade Statistics, Financial Statistics Monthly Report, May 2003, Ministry of Finance, Executive Yuan, Taiwan.

Although there are political conflicts between Taiwan and China, there are clear signs of economic integration between them. This economic integration has resulted in mainland China being one of Taiwan's most important trading partners, even though much of this trade is indirect and conducted through Hong Kong and Singapore. This trading arrangement began in the late 1980s at a time when Taiwan faced pressure from the US to reduce the bilateral trade gap and look elsewhere for new markets. The government response was to allow indirect trade between Taiwan and China, which was achieved very successfully although there is now a higher level of dependency on these markets. Evidence of this is shown by a rise from 9% of exports to China in 1991 to 17% in 1996 and by 2002, China has overtaken the US as the primary markets for Taiwan exports.

Table 1.7 shows the extent of indirect exports to China, most of which go through Hong Kong. This trade grew steadily, with the exception of the 1997-8 financial crisis and the recession in 2001. However, since the return of Hong Kong to Chinese control in 1997, the Taiwanese business community appear wary of the new levels of governance and the indirect benefit from trade through Hong Kong has slowed considerably.

Table 1.7. Direct and Indirect Taiwanese Trade with China, 1987-2002

Year	Total Trade with China		The Trade through Hong Kong		
	Total Export	Increase Rate (%)	Indirect Export	Indirect Import	Net Trade
1987	1,227	51.2	1,227	289	938
1988	2,224	81.4	2,242	479	1,764
1989	3,245	45.9	2,897	587	2,310
1990	4,171	28.6	3,278	765	2,513
1991	6,928	66.1	4,667	1,126	3,541
1992	9,697	40	6,288	1,119	5,169
1993	12,728	31.3	7,585	1,104	6,482
1994	14,653	15.1	8,517	1,292	7,225
1995	17,898	22.2	9,883	1,574	8,309
1996	19,148	7	9,718	1,582	8,135
1997	20,518	7.2	9,715	1,744	7,971
1998	18,380	-10.4	8,364	1,655	6,709
1999	21,221	15.5	8,175	1,628	6,547
2000	26,144	23.2	9,593	1,981	7,613
2001	24,061	-8	8,812	1,693	7,118
2002	29,446	22.4	10,312	1,708	8,604

(Unit: Million US$)
Source: Statistical Tables (International Trade) - Economic Statistic Annual, 2003 edition, Ministry of Economic Affairs Executive Yuan, Taiwan.

Foreign Investment[10]

The Taiwanese government has actively encouraged inward foreign investment since the late 1940s, when a comprehensive scheme of benefits and incentives was established. The presence of foreign investors has played a critical role in the economic transform of Taiwan, providing capital, technology and experience to assist industrialisation. Between 1952 and 1964, the value of foreign investment into Taiwan was approximately US$93 million and increased to US$466 million between 1965 and 1970. Between 1952 and 1981, US$3114 million has been invested in Taiwan from overseas. However, since the mid 1980s, increasing labour costs and a strong currency have made inward investment less attractive while, at the same time, a highly skilled workforce and the introduction of quality technology has resulted in Taiwanese firms themselves looking overseas for cheaper resources.

According to the World Investment Report (2002), over 90% of global outward foreign

[10] The discussion relies on "Annual Report of Approval Statistics: Inward, Outward Investment and Investment

direct investment (FDI) now comes from the developed countries of North America and Western Europe and the IMF (World Economic Outlook, 2002) indicates that the emerging and developing countries are following the same pattern, with over 60% of FDI from this group coming from Hong Kong, Taiwan, Singapore and South Korea. Data from the Investment Commission of Taiwan shows that, between 1991 and 1995, the annual mean outward FDI from Taiwan was US$24.5 thousand million, or nearly 1% of global outward FDI. From 1995 to 2000, annual mean outward FDI value from Taiwan was almost double reaching US$48.1 thousand million although the share fell to 0.88%. But clearly, Taiwan has been one of the 20 largest capital exporting countries in every year since 1991. In the past 20 years, Taiwan has moved from being a net recipient to one of the major FDI exporting countries.

Table 1.8 shows the pattern of outward FDI from Taiwan to all countries, apart from China, between 1987 and 2002. With a few exceptions, this has grown at an average rate of 46% per year. The main recipient is the US, with an increase from US$70 million in 1987 to US$1092 million in 2001. After the US, the South East Asian countries are a primary source of foreign investment opportunities, although this dropped during the period of the crisis. Obviously, the highly uncertain economic situation in the South East Asia was an effective deterrent. The large amounts of FDI that have flowed into tax-haven countries (such as those in Central America and the islands in the Atlantic and Pacific oceans) are not included in the Table. The Economic Daily, a local newspaper in Taiwan, claims the value of FDI invested in tax haven is even higher than the investment value into the US. FDI to Western Europe is low on all counts.

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to China", 2003 edition, Investment Commission, Ministry of Economic Affairs, Executive Yuan, Taiwan.

Table 1.8. Value of Outward FDI from Taiwan (excluding China), 1987-2002

	Total	Growth	US	Japan	H.K.	Singapore	S.E. Asia	Europe
1987	102,751	81%	70,058	3,481	1,283	1,301	14,787	199
1988	218,736	113%	123,335	1,972	8,060	6,433	52,729	12,005
1989	930,986	326%	508,732	335	10,372	5,209	276,873	2,333
1990	1,552,206	67%	428,690	1,807	33,092	47,622	519,760	96,176
1991	1,656,030	7%	297,795	3,431	199,630	12,540	690,097	60,289
1992	887,259	-46%	193,026	5,321	54,447	8,790	300,336	45,933
1993	1,660,935	87%	529,063	63,297	161,918	69,473	364,170	255,913
1994	1,616,764	-3%	143,884	22,731	127,284	100,732	296,999	22,209
1995	1,356,878	-16%	248,213	8,811	99,555	31,649	294,449	59,868
1996	2,165,404	60%	271,329	6,798	59,927	164,978	422,290	11,875
1997	2,893,826	34%	547,416	32,342	141,593	230,310	410,931	58,508
1998	3,296,302	14%	598,666	29,596	68,643	158,176	319,318	33,828
1999	3,269,013	-1%	445,081	121,867	100,318	324,524	197,656	60,982
2000	5,077,062	55%	861,638	312,222	47,512	219,531	169,915	36,751
2001	4,391,654	-14%	1,092,747	169,033	94,901	378,301	145,038	45,594
2002	3,370,046	-23%	577,782	23,554	167,064	25,760	185,103	123,416
Average	2,152,866	46%	433,591	50,412	85,975	111,583	291,278	57,867
Percentage	100%	-	20%	2%	4%	5%	14%	3%

(Unit: Thousand US$)
Source: Statistical Tables (Investment) - Economic Statistic Annual, 2003, Ministry of Economic Affairs, Executive Yuan, Taiwan.

As with the trading relationship with China, Taiwan FDI to China is a fairly recent phenomenon, and this occurs mostly through Hong Kong and Singapore. The Investment Commission of Taiwan reports the average value of investment up to 2002 was US$2,773 million and represents 49% of total FDI (see Table 1.9). However, this again creates a dependency that may be undesirable. This was made worse when funds withdrawn from South East Asia at the time of the crisis was redirected to China, such in 2001, FDI from Taiwanese firms to China amounted to US$6,723 million and made up the majority of all outward investment undertaken that year.

Table 1.9. Taiwanese Outward FDI by region, 1993-2001

Year	Total Overseas		South East Asia		China	
	Value	Growth	Value	Growth	Value	Growth
1993	1,660,935	87%	364,170	21%	3,168,411	1183%
1994	1,616,764	-3%	296,999	-18%	962,209	-70%
1995	1,356,878	-16%	294,449	-1%	1,092,713	14%
1996	2,165,404	60%	422,290	43%	4,334,313	297%
1997	2,893,826	34%	410,931	-3%	2,034,621	-53%
1998	3,296,302	14%	319,318	-22%	1,252,780	-38%
1999	3,269,013	-1%	197,656	-38%	2,607,142	108%
2000	5,077,062	55%	169,915	-14%	2,784,147	7%
2001	4,391,654	-14%	145,038	-15%	6,723,058	141%
Average	2,858,649	24%	291,196	-5%	2,773,266	177%

(Units: Thousand US$)
Note: Values of "Total Overseas" excludes the investment in China.
Source: Annual Report of Approval Statistics: Inward, Outward Investment and Investment to China, 2003 edition, Investment Commission, Ministry of Economic Affairs, Executive Yuan, Taiwan.

Finally, it is important to consider two further aspects of FDI: the distribution by industrial and by geographical region. Table 1.10 illustrates the distribution of FDI across industry in China between 1992 and 2001. As the table shows, these investments have changed from the traditional labour-intensive industries (such as food and plastics), to technology-intensive industries, and in particular to electronics. In 1992, the value of Taiwanese investment value in the food and plastics sectors was 19% and 18% of total investment respectively. However, in 2001, this fell to 2% and 6% of total investment value. In contrast, that directed to the electronics sector was 14% in 1992, and continually increased thereafter, with an accelerated growth rate following the Asian crisis, that reached 45% in 2000.

Table 1.10. The Sectional Distribution of Taiwanese FDI in China, 1992-2001

	Total	Food	Plastic	Metal	Electric	Machinery	Others
1992	246,992	46,415	44,961	10,664	34,555	18,015	92,382
Percent		19%	18%	4%	14%	7%	37%
1993	3,168,411	324,555	375,920	256,501	445,008	286,492	1,479,935
Percent		10%	12%	8%	14%	9%	47%
1994	962,209	145,846	73,302	90,328	157,011	44,162	451,560
Percent		15%	8%	9%	16%	5%	47%
1995	1,092,713	117,447	62,736	116,805	214,796	29,454	551,475
Percent		11%	6%	11%	20%	3%	50%
1996	4,334,313	333,073	349,116	395,967	875,044	247,249	2,133,864
Percent		8%	8%	9%	20%	6%	49%
1997	2,034,621	70,045	64,184	126,849	758,975	74,617	939,951
Percent		3%	3%	6%	37%	4%	46%
1998	1,252,780	58,250	99,074	104,494	537,751	28,073	425,138
Percent		5%	8%	8%	43%	2%	34%
1999	2,607,142	43,253	184,776	183,854	1,464,775	84,797	645,687
Percent		2%	7%	7%	56%	3%	25%
2000	2,784,147	58,420	156,067	193,797	1,254,834	125,997	995,032
Percent		2%	6%	7%	45%	5%	36%
2001	6,723,058	152,939	398,820	631,461	2,618,684	433,348	2,487,806
Percent		2%	6%	9%	39%	6%	37%

(Units: Thousand US$)

Source: Statistical Tables (Investment) - Economic Statistic Annual, 2003, Ministry of Economic Affairs, Executive Yuan, Taiwan.

The last Table presents the spatial distribution of Taiwanese investment in China. In Table 1.11 it is clear that between 1992 and 2001, investment in China has shifted from the provinces on the south coast to those in the central coastal regions. In 1992, the value of investment in the south coast area, including the provinces of Guandong, Fujian and Hainan, was approximately 57% of the total. By 2001, this share of the total had dropped by 39% in favour of the mid-coastal provinces, particularly Jiangsu close to Shanghai, and which accounted for nearly half of Taiwanese investment to China.

Table 1.11. The Geographical Distribution of Taiwanese FDI in China 1992-2001

	Total	South Coast			Middle C.	North Coast	
		Guangdong	Fujian	Hainan	Jiangsu	Hebei	North East
1992	246,992	112,038	29,584	1,535	34,389	22,271	15,839
Percentage		45%	12%	1%	14%	9%	6%
1993	3,168,411	1,047,811	473,800	61,954	833,307	194,299	68,345
Percentage		33%	15%	2%	26%	6%	2%
1994	962,209	230,927	96,624	9,115	391,814	56,814	11,488
Percentage		24%	10%	1%	41%	6%	1%
1995	1,092,713	222,748	121,656	649	394,772	83,194	43,539
Percentage		20%	11%	0%	36%	8%	4%
1996	4,334,313	1,720,900	472,229	37,984	1,247,297	233,565	62,768
Percentage		40%	11%	1%	29%	5%	1%
1997	2,034,621	824,419	150,793	12,997	694,751	92,421	10,499
Percentage		41%	7%	1%	34%	5%	1%
1998	1,252,780	500,114	58,899	388	475,008	57,281	10,289
Percentage		40%	5%	0%	38%	5%	1%
1999	2,607,142	1,019,703	99,486	1,595	1,251,623	92,630	14,380
Percentage		39%	4%	0%	48%	4%	1%
2000	2,784,147	787,972	120,122	2,403	1,422,590	125,228	18,950
Percentage		28%	4%	0%	51%	4%	1%
2001	6,723,058	1,635,092	749,942	6,260	3,172,313	275,275	62,105
Percentage		24%	11%	0%	47%	4%	1%

(Units: Thousand US$)
Source: Statistical Tables (Investment) - Economic Statistic Annual, 2003, Ministry of Economic Affairs, Executive Yuan, Taiwan.

Foreign investment in China does allow Taiwanese companies to acquire cheap labour and resources, which would be particularly helpful for the traditional labour-intensive industries in Taiwan. However, the scale of investment in China has given cause for concern as the export markets previously enjoyed by Taiwan are now benefiting China. Exports from Taiwan to the US have decreased from a market share of 6% in 1987 to 4% in 1998, whereas Chinese exports to the US have increased their share from 1.5% to 8%. Over the same period, this export diversion effect is also seen in the level of Taiwanese exports to China, and China's reliance on Taiwanese technology is now eroded due to local production. Indeed, apart from the issue of export diversion, the higher level of dependence on the success of foreign investment in the Chinese economy increases the level of risk to Taiwan. One reason that the contagion resulting from the Asian crisis did not affect Taiwan too seriously

was the relative independence of its economy from that region. However, if a similar crisis were to occur in China, this would have a devastating effect on Taiwan and government policy is currently directed towards advising firms to diversify investments in order to decrease potential vulnerability. The continued rapid growth of FDI to China indicates that these warnings are going unheeded for the time being.

Conclusion

In this chapter, the focus has been on the critical contextual factors that underpin this research on Taiwan, in particular those relating to corporate governance and the foreign investment decisions of publicly-traded firms. The first section reviewed the economic environment that firms operate in and the changes in financial sector regulation that are pertinent to business funding decisions. The importance of trade and changes in the pattern and distribution of trade are presented, as well as a brief historical background on how these relationships developed.

The domestic economy in the last century was driven by a policy of export promotion and foreign expansion, both of which have been highly successful. However, customs and culture, especially the traditional values placed up on human relationships and family hierarchy, have influenced the approach to commercial activities and these issues were addressed in the second section. One change that has impacted upon the structure of the markets is the presence of institutional investors, both domestic and foreign. This was seen as a way to address problems of illiquidity and asymmetric information, and to improve the level of price efficiency on the TSE. Certainly, the introduction of foreign-owned institutions should be seen as a positive influence upon the security markets and should promote more active trading based on firm fundamentals rather than the herd instincts of the domestic investors.

The final section reviewed the extent of internationalisation of the Taiwanese economy

in terms of international trade and foreign investment. Taiwan is very much part of the global economy, in the past, notably the US and Japan, and more recently with China. Tax havens also feature in this framework of FDI. The relationship with China has undergone various changes in both sectoral involvement and location, but the growing level of dependence on China is causing some concern. The economic environment, customs and practice in the business community, governance systems within firms and patterns of foreign direct investment will all be addressed in the empirical chapters of the thesis.

Chapter Two: The Nature of Corporate Governance in Taiwan

Introduction

The institutional framework for corporate governance in Taiwan draws from both Company Law and Securities and Exchange Law. Company Law specifies the contractual relationship between management and the providers of capital, where the obligation of managers is to ensure the interests of shareholder. Conversely, the role of Securities & Exchange Law is to provide some protection to investors trading on the Taiwan Stock Exchange. This includes regulations about the disclosure of company information, such as audited accounts, and reporting equity transaction, both of which ensure transparency and accountability.

As discussed in .Chapter I, the political and economic history of Taiwan has been dominated by a combination of Dutch, Japanese, and latterly, Chinese influences and many of these remain. Of these, the most enduring has been those following the continental legal system, the civil law tradition, such as German and Japan rather than the oceanic legal system, or the common law tradition, such as in the US and the UK. Moreover, in many respects, the corporate governance in Taiwan is unique, not fitting easily into either of the standard frameworks.

This chapter briefly discusses aspects of the legal framework that are relevant to the later empirical sections. The requirements of Company law, the regulations around the required ownership of equity by board members, and the characteristics of board members and supervisors, all play an important role in the subsequent analyses.

Company Law

Under Company Law, the board of a Taiwanese firm has a two-tier structure, consisting of a board of directors and a further group of supervisors. The shareholders take the role of principal in traditional corporate governance terminology, and are able to exercise their voting

rights at shareholders' meetings, and to elect both directors and supervisors. Company law stipulates that shareholders' meetings should take place at least once a year, and the management has an obligation to inform shareholders about the meeting at least twenty days in advance in the case of owners of inscribed stock, and thirty days in advance for nominated stockholders. The board of directors or a significant number of shareholders that control at least 3% of total issued equity can convene an additional extraordinary meeting, if it is required due to an urgent event.

The composition of the board of directors is strictly defined. No less than three directors comprise the board, and this board holds discretionary powers delegated by the shareholders to perform the functions of management and have the authority to decide most issues related to corporate operations. Regulation 202 stipulates that all operations should be decided by the board of directors, except those that are explicitly to be decided at shareholders' meetings. The board of directors are obligated to undertake all decisions in the best interests of the company, and with the aim of maintaining the value of the firm.

Company Law stipulates six explicit obligations that directors are bound to adhere to: the preparation of documents of internal constitution, reporting critical issues at the shareholders' meeting, declaring bankruptcy if the situation arises, convening shareholders' meetings on time, making accounting statements conform to the requirements of supervisors for monitoring and not acting illegally. These six articles are enshrined in company law and as to protect the interests of both corporate debtors and creditors and to ensure the effectiveness of the supervisors.

In contrast to the board of directors, Company Law does not require a minimum number of supervisors, except that at least one should be resident in Taiwan. Supervisors are restricted to individuals that are a director, a manager, or other employee in the company, so as to maintain objectivity but also knowledge of the firm and its operations.. Each supervisor monitors independently rather than acts by the common consensus of the whole group. This

is an important point in Taiwanese company law and the different roles of supervisors and directors are emphasised by the use of "board" for directors and not for supervisors.

The principal role of the supervisor is to monitor the actions of directors and report any impropriety, abuse of discretionary power or action that is likely to cause a fall in the value of the firm. According to the latest edition of the Taiwan company law, regulation 218 states that supervisors are able to attend meetings of the board to pass an opinion about corporate decisions. Moreover, in the case that decisions of the board have violated the corporate constitution or where resolutions agreed at shareholders meeting are reversed or ignored or where decisions are actually illegal, the supervisors have an obligation to insist that directors amend their decision or halt operations. To ensure effective monitoring, supervisors have the right to audit managerial activities at any time and authorise lawyers and accountants to provide specialist expertise. They also have the power to convene a shareholders meeting independently if any other attempt to address directors shortcomings is resisted. Thus, it is clear that the mechanisms for supervisory monitoring are in place. However, some issues remain pertaining to the efficiency of supervisors and their independence from the board of directors are addressed in later chapters -

Securities & Exchange Law

For listed, publicly-traded, companies, ownership is more diffused and the monitoring mechanisms to ensure good corporate governance are weaker and not adequately defined by company law. Dispersed investors find access to information about corporate operations more difficult and rely heavily on published information, which is clearly an important factor in their investment decisions. Thus, a Securities and Exchange Law was established in 1968 to respond to the need for regulation to provide investor confidence and enhance the quality of governance and hence the integrity of the market.

The Securities and Exchange law is enforced by the Securities and Futures Commission (SFC), a governmental agency supervised by the Ministry of Finance, and the market regulator for the Taiwan Stock Exchange (TSE). SFC has wide ranging powers in respect to the administration of the market and is responsible for the approval of newly-issued securities, overseeing market trading, licensing the securities' traders, the regulation of market intermediaries and settlement rules.

To ensure the accountability of published information, the SFC imposes discipline on publicly-traded companies to disclose the status of corporate operations in a clear and timely manner. This is provided in annual, semi-annual and quarterly financial statements from all listed companies, and all the information is required to be audited and certified by accredited accountants (CPA – Certified Public Accountant). If companies fail to report within the specified time, trading is suspended until the reporting is acceptable.

The SFC is also concerned with the probity of managers and monitors the extent to which their interests are aligned with those of the shareholders. Regulation 26 of the Securities and Exchange Law stipulates minimum proportion of shareholding for members of the board of directors and for the supervisors in all publicly-traded companies – see Table 4.1.

Table 2.1: Statutory Shareholdings in Listed Companies

Firm Capitalisation (New Taiwanese Dollar)	Minimum Required Shareholding	
	Board of Directors	Supervisors
< 300 mil NT$	15%	1.50%
300 mil NT$ - 1000 mil NT$	10%	1.00%
1000 mil NT$ - 2000 mil NT$	7.50%	0.75%
> 2000 mil NT$	5.00%	0.50%

Source: Securities and Exchange Law, Regulation 26.

In addition, public companies in Taiwan are required to report the trading activity of all directors and supervisors to the SFC on a monthly basis. Further, this report should explicitly state all changes of ownership for significant shareholders - those with holdings of more than

10% of the issued capital. This is quite rigorous to include the changes in collateralised equities on the shareholdings of board members and significant shareholders.

Except for these regular disclosure obligations, interim statements may be required and thus the SFC can promulgate rules and guidelines towards special disclosure requirement that may affect shareholders' interests. Information disclosed on this basis includes events that may have an impact on stock prices and shareholders' equity, matters regarding the offering and issuance of securities, the acquisition or disposal of assets, foreign investment in mainland China and changes to accounting principles.

In addition, to protect the rights of minority shareholders and creditors for affiliated corporations, Company Law (369-12) additionally requires that information is disclosed on a consolidated basis. Particularly, at the end of each financial year, the controlling company and affiliates of a public company are required to prepare a consolidated business report, including group financial statements and details of the legal and ownership relationships within the group. Moreover, due to the increasing number of business affiliates in Taiwan, the SFC published the "Guidelines for Compilation of the Group Companies Management Report, the Consolidated Financial Statements, and the Relationship Report" in 1999 and required that the three reports include the following:

- The Group Companies Management Report: The contents include the organisational chart, shareholding status of directors, supervisors and the general manager, the related party transactions among group members, financial status and operational results of each company, etc.
- The Consolidated Financial Statement: the contents shall include financing accommodation among group members, endorsement or guarantee, transactions on derivative products, material matters, after day items, and the holding of bills and securities.

- The Relationship Report: the contents shall include the purchasing and selling of goods and asset transactions, financing, and endorsement among group companies.

International Comparisons

Comparison with the UK-US System

The institutional structure of Taiwanese firms has a number of unique features, which set it apart from systems in other countries. Compared with the Anglo-American system, there are important differences with regard to the independence of the board of directors and the allocation of seats on the board. Compared with the Anglo-American style of legal system, which endorses "competence" and "independence" in the board of directors, the institutional framework in Taiwan stresses that the interests of company controllers should align with corporate value. The concept is rooted in the German system prior to 1937 and the Japanese system prior to 1951. In practice, the fundamental aspects of the institutional framework are to limit the possibility that an independent outsider has a role in corporate management, and to ensure that significant shareholders play roles as director and supervisor. This is clearly a departure from the US-UK model. Further, to guarantee the alignment of interest between corporate owners and control, Taiwanese company law stipulates in regulations 192 and 216 that all members of the board of directors and all supervisors must be shareholders. Since November 2001, the regulations compelling all directors and supervisors to hold shares has been repealed, however, the Security and Exchange Law still requires a minimal shareholding for the board of directors and the supervisors. Thus, although an individual director or supervisor is not required to hold any equity, this makes them essentially powerless and truly independent directors or supervisors are rare.

Another difference between Taiwanese and Anglo-American firms relates to the regulations allowing a "legal person" to act as a director or supervisor. A "legal person" in

Taiwan is defined as an institution, or a legal entity, that is not an individual, but which has the right to own assets, sign contracts and sue or be sued. In Taiwan the directors and supervisors are designated as either a natural person or a juridical person, both of which must comply with the shareholding requirement. Regulation 27 of company law states a legal person is entitled to hold a director or supervisor role of company and can assign any natural person as a representative on its behalf. In addition, the Regulation stipulates that a single legal person can simultaneously have numerous representatives as directors or supervisors, and there are no restrictions on the proportion of the board that can be represented in this way.

The regulations with respect to legal persons can have a serious impact on board structure and can obstruct the voice of minority shareholders. Moreover, the regulations can encourage ownership interlocks among corporations, and thus allow coalitions to repel potential challengers, concerning control rights or market competition. In the US, antitrust laws prohibit the acquisition of shares in a company if this is likely to have adverse effects on competition as a result. Moreover, the relatively strict standard of conduct for directors regarding conflicts of interest tends to prevent the development of interlocking shareholdings among firms with long-term relationships.

The influence of the continental legal tradition is clearly reflected in the institutional structure of Taiwanese firms. According to the Company Law, the Taiwanese company is required to have a two-tier board structure, putting the system apparently closer to that of Germany and Japan than to the US, UK. Further, in common with most countries with two-tier board structures, the supervisor in Taiwan has wide powers to monitor and discipline management, to the extent that they can select and deselect senior management, provided they have the support of the shareholders.

Comparison with the Germany-Japan System

Nevertheless, even within the group countries that share a similar legal tradition, such as Germany, France and Japan, the idiosyncrasy of the Taiwanese corporate governance system remains. The distinctness of the Taiwanese system in this group is reflected in the four aspects that follow. First, with respect to the function of supervisors, in Germany and France, the monitoring role takes place through the common consensus of all supervisors rather than by individual supervisors as in Taiwan. This is reflected in the independent nature of supervisors in Taiwan, where the supervisors are considered as individuals rather than as a supervisory board as in other two-tier board systems. In fact, the supervisors in Taiwan tend to have similar role as inspectors in the French system, in which, in addition to supervisors, all companies are required to have additionally one or two places on the supervisory board reserved for external inspectors to strengthen the degree of scrutiny. However, the supervisor in Taiwan differs from the French inspector in that the form is explicitly required to be a shareholder rather than an outsider.

The second difference that exists between Taiwan and the other continental countries concerns board composition. In Germany and France, a specific proportion of supervisor positions are reserved for labour union representatives, while in Taiwan, the positions are required to be held by shareholders only. This means the supervisors in Taiwan tend to support the management rather than other stakeholders. The two-tiered nature of German and some French boards represents an attempt to formalise the different roles of outside and inside directors, since the supervisory board consists of members other than the current management, while the board of directors consists of serving managers. However, this arrangement is absent in the institutional framework of corporate governance in Taiwan, where members of a single family or a legal person can simultaneously be on the board of directors and a supervisors, as long as the shareholding requirement is met.

Further differences within governance models between Taiwan and those in Germany, France and Japan relating to the board of directors and supervisors are concerned with scale. In Japan, commercial law (1993 edition) specifically requires that at least three supervisors should be appointed in a large company, one of which should be an outsider, that is, an individual who has not worked for the company during the previous five years. This does not hold in small companies in Japan. In Germany, companies with less than 500 employees are not required to have a two-tier board structure to separate boards of supervisors from board of directors. However, for company with between 500 and 2000 employees, it is necessary to one third of supervisors dedicated to labour union representatives. Further, when a company employs more than 2000, 50% of supervisory positions are reserved for labour representatives. However, while the institutional framework in Taiwan also requires higher standards of governance for larger firms, this is restricted to concerns about maintaining the alignment of interests between managerial shareholding and firm value (see Table 4.1), with no emphasis on the monitoring capacity and the representation of labour or other stakeholders.

Finally, the factor that most clearly differentiates the structure and role of both the board of directors and the supervisors in Germany and Japan from that of Taiwan is the relationship between the corporate and banking sectors, resulting in major variations in the system and effectiveness of corporate governance. In Japan and Germany, banks are usually the most significant financial providers to companies. Given their sufficient shareholding, banks are usually major holders of equity and are able to exert considerable influence on the boards of directors and supervisors, having positions on both boards. Banks have a very close relationship with the firm, are knowledgeable on areas of finance, operations and other commercial issues, which provides an environment for highly effective monitoring. Although they may have a tendency toward conservatism, the independence of the bank in corporate affairs as a means of monitoring and supervision supports the expectation of a positive impact of a bank-dominated board on corporate governance. However, compared with this system

prevalent in Germany and Japan, banks or other financial institutions are rarely involved in monitoring Taiwanese firms. The institutional regulations in Taiwan that identify a legal person as an individual entity in corporate governance can be seen as an attempt to provide a channel for external supervision, while the effect of this legislation to discipline better corporate governance quality is controversial. Moreover, the material evidence supporting the legislation leading financial organisations to more actively participating in corporate governance remains unobservable thus far.

Evidence of Corporate Governance in Taiwan

As with many other countries, the institutional framework enabling corporate governance to be effective in Taiwan is not complete. In particular, the level of development of the Taiwanese economy remains at an intermediate stage of entrepreneurial capitalism, with many firms owned and managed by families. Although the share of equity ownership by the founding family is becoming less significant, especially in the case of publicly-traded companies, these firms are still perceived by the general public to be family-dominated. Accordingly, even though the involvement of the founding family has reduced, its overwhelming power in management remains. This reveals that the system is unsuccessful in align management interest with corporate value, which is the fundamental factor is ensuring good corporate governance in Taiwan.

Table 4.2 compares the corporate insiders' shareholding of publicly-listed companies on the TSE in 1985 and 1999. The corporate governance system in Taiwan encourages senior managers to have a greater amount of shareholding. However, according to the table, the percentage of corporate insiders' shareholding has decreasing significantly during the period, and there is now a lower proportion of listed-companies with a concentrated ownership structure. This demonstrates the gap between the interests of ownership and control has increased and the alignment of interest between managerial ownership and firm value has

been eroded. This new phenomenon for Taiwan is likely to lead to a conflict of interest between small groups of controlling shareholders and the remaining majority of shareholders.

Table 2.2 Insider Ownership of Public-Listed Firms on the TSE

Insiders* Ownership Ratio	Apr-85		Aug-99	
	Firm Number	Percentage	Firms Number	Percentage
0~9.9%	3	2.68%	83	18.28%
10~19.99%	32	28.57%	160	35.24%
20~24.99%	21	18.75%	42	9.25%
25~29.99%	18	16.07%	44	9.69%
30~39.99%	9	8.04%	68	14.98%
40~49.99%	10	8.93%	31	6.83%
50~59.99%	12	10.71%	14	3.08%
60~69.99%	4	3.57%	7	1.54%
70~79.99%	1	0.89%	4	0.88%
80~89.99%	0	0	1	0.22%
90~100%	2	1.79%	0	0
total	112	100.00%	454	100.00%

Note: *Insiders are referred to Directors and Supervisors

Source: 2002 Annual Report, Taiwan Stock Exchange Corporation, Taiwan.

Moreover, in a society dominated by family businesses like Taiwan, the hierarchical relationship between directors and those concerned with monitoring the firm can be confused and distorts the definition of what constitutes good corporate governance. The independence and integrity of directors and supervisors is crucial for the effective implementation of a culture of governance that matches that intended by the institutional framework established by the regulatory measures introduced.

These issues are not purely of interests to academics and the legal profession. A leading article in the Taiwan Economic Daily News (12/Decembe/2002) notes the defects of corporate governance system, highlighting four major questions. Firstly, with the tradition of family control and the articles in the Company Law that prohibit and directors from outside the firm, all members of the board are direct stakeholders. Further, most significant

shareholders act as directors, while the appointment of supervisors depend on the votes of these significant shareholders. This results in a very weak position for the supervisors and they are unlikely to question those shareholder-directors on management issues. Secondly, again acting within Company Law, an organisation is treated as an individual in corporate governance terms, and is allowed to have several representatives holding positions as director and/or supervisor, while the mechanisms to prevent shareholder interlocking across firms are incomplete. Thirdly, there is no limit to the number of firms that an individual can be involved with, whether as a director or supervisor, as long as the necessary shareholding is met. And, finally, as the founding family usually holds the largest share of equity, it is not difficult for them to arrange for a family member to serve as a director or supervisor in the firm. Consequently, the board of directors, including the chairman, and the supervisors are commonly members of the same family, with examples of close family members being the chairman, board members and supervisors, not unknown.

This concern in the media is replicated in another local financial journal, the Wealth Magazine (May, 2002), where it was reported that five leading technical companies in Taiwan, including the one once with the highest capitalisation on the Taiwan Stock Exchange, had a husband and wife team as supervisor and chairman of the board of directors. The report concluded that independent monitoring in these companies was seriously in doubt and questioned the effectiveness of such monitoring arrangements. It is clear that in the minds of the public, family ownership and family control is open to abuse and does not result in any confidence that high levels of corporate governance can be expected in Taiwan under the current institutional framework.

Conclusion

In this chapter, the institutional framework of the corporate governance system of Taiwan has been reviewed. Specifically, Company Law and Securities and Exchange Law, plus the

disclosure regulations required by the SFC, have formed the basis for corporate governance in Taiwan, although this system is distinct from those of most countries in the world. However, the limitations due to the incomplete institutions are itself to make the system ineffectual and jeopardise corporate governance in Taiwan. The imperfections of the system have been widely criticised by the public media and the latter part of chapter was focused on this. It is clear that the prospect of a system of good quality corporate governance is doubtful. Corporate controlling status, ownership distribution, board composition, and most importantly, the interference of the controlling family on management are all aspects of the present model of corporate governance in Taiwan. These all have to be addressed is the system is to improved.

The following chapters will focus to test these critical corporate governance factors in Taiwan and link them to the issues of firm performance in the domestic economy, and also to the strategic decision with respect to international expansion, both in a familiar cultural environment and in other global markets. The examinations are expected to address some of the corporate governance concerns increasing surfacing in countries dominated by family controlled firms.

Chapter Three: The Literature on Corporate Governance

Introduction

As the illustration by Berle and Means (1932), one of the defining characteristics of the modern corporation is that companies have the ability to raise finance through external capital markets, and this has made the separation of corporate ownership and control a central issue for both researchers and the business community. Individuals holding shares in publicly-traded companies do so for investment purposes rather than to become involved in corporate decision-making. However, the lack of active monitoring to discipline the controllers of the firm, may allow managers' self-interest to encroach on corporate decisions and thus neglect to maximize the efficient operation of the firm. This moral hazard will detract from corporate value and shareholders' interests, hence the principal and agent problem.

To limit appropriation on the part of managers, a number of mechanisms to ensure good governance, plus high profile failures in recent years, for example, Barings and Enron, have increased the level of interest in the topic at many levels. Regulators have clearly been concerned, shareholder groups are more proactive and academic research has focused on developing methods of theoretical model and empirical examination of systems of governance in a number of national contexts. This chapter review the major work in the area and provides a theoretical foundation for the empirical analysis that follows.

The Agency Problem

Incomplete Contracts

The agency problem is concerned with the contractual view of the firm, which arises from the pioneering work of Coase (1937). In this seminal paper, "The Nature of the Firm", Coase argues that firms exist in order to facilitate exchange and to improve the efficiency of resource allocation within the context of a free market. With the establishment of employment contracts

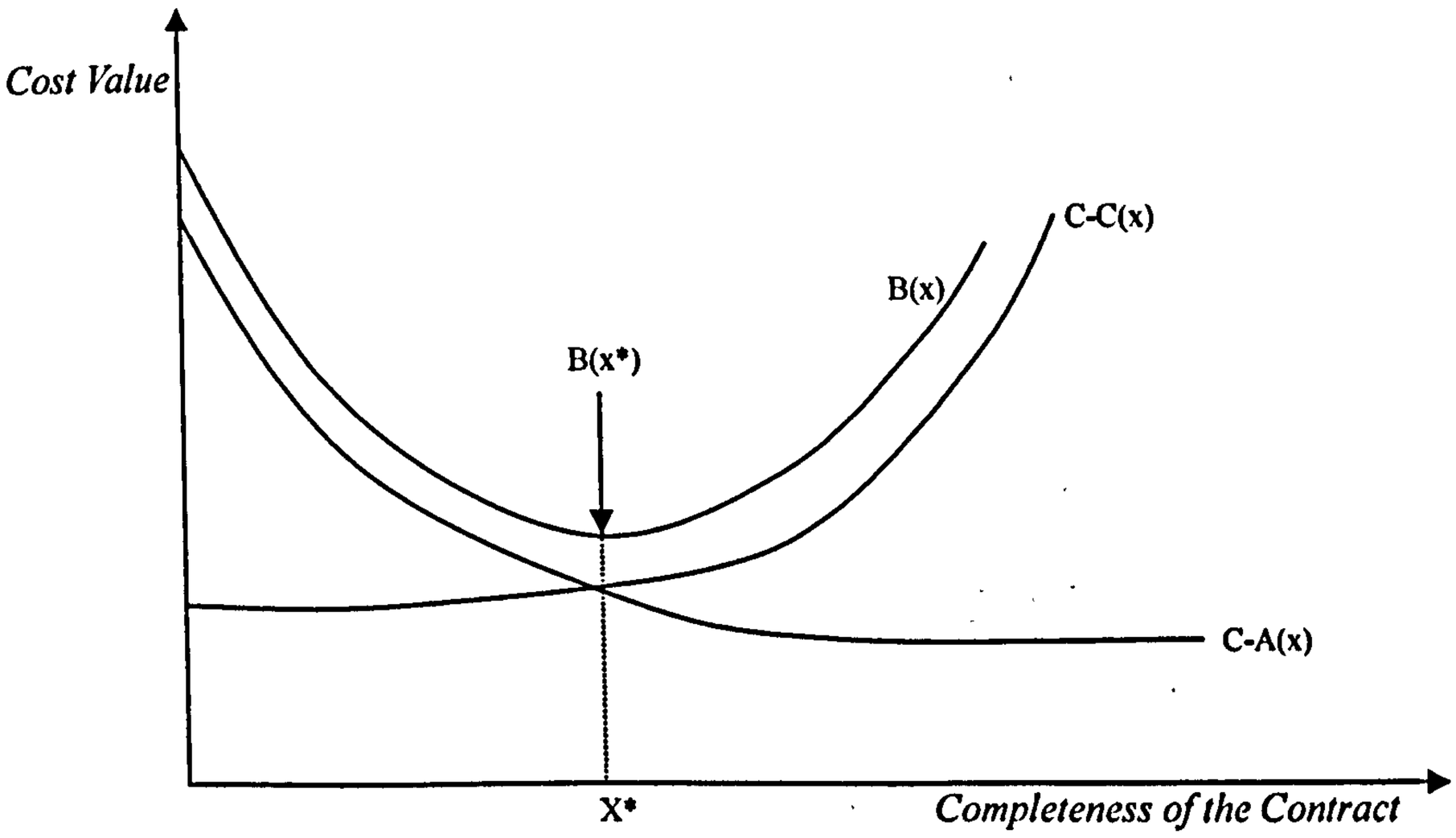
within the firm, such as the hierarchical relationship under the authority of a manager, transactions costs can be minimised. However, as firms grow large, managers find control of employees difficult as the distance between levels of labour increases. Jensen and Meckling (1976) extended this theory by explicitly advocating that contractual relations are an essential element of the firm, further defining the firm as a form of legal function serving as a centre for the coordination of contractual obligation (nexus of contracts).

Applying the contractual concept to the relationship between corporate ownership and control is useful when explaining the behaviour of the providers of capital. In this case, there is an invisible but important contract between the shareholders and the managers that is based on the expectation that there will be no inappropriate use of funds. However, the implicit contract is incomplete. In the literature, the contract is referred to as a contingent claim, and will only be met if all outcomes are observable and there is no possibility for adverse selection or moral hazard, both of which are needed for the contract to be complete. However, according to incomplete contract theory (Grossman and Hart, 1986; Hart and Moore, 1990; Hart, 1995a, 1995b), most future contingencies relating to the contract are extremely hard to predict *ex ante*. Even though it may be possible for some agents to be aware of all contingencies that might affect the relationship in the future, their knowledge is unlikely to be transformable into a clear and enforceable contract because of their inability to verify all the relevant variables. After all, to validate a contractual relationship, any parties involved in the relationship should communicate the terms of the contract to all internal and external parties. Without a clear and definite statement in the contract, outsiders usually have little knowledge about the contractual agreement and do not recognise the existence of the relationship at all.

The inability to enforce a complete contract is the limit of "bounded rationality" and "uncertainty" – two of the central concepts of Williamson's work on the governance mechanisms within firms (Williamson, 1971, 1975 and 1985). Large number of agents would be involved in the specific set of complete contracts, not just to predict all possible

contingencies but also to state their outcomes unambiguously. This would be a very costly practice, if possible at all. Thus, since the reality is that a complete contract is technologically and economically infeasible, incomplete contract theory argues the conflicts between manager and financier will occur frequently when addressing corporate residual rights.

Figure 3.1. The Optimal Contract - Incomplete but Lowest Agency and Contracting Cost Combination



Source: Grossman and Hart (1986)

Based on the consideration that huge costs are unavoidable in achieving a complete contract between ownership and control, the simple Grossman-Hart-Moore model (Grossman & Hart, 1986) illustrates why an incomplete contract can be acceptable – see Figure 2.1. If x represents the completeness of the contract, the C-A(x) represents the responding agency cost function. The curve C-C(x) is the cost function representing the costs associated with the improvement of contract completeness, and this continuously increases with the value of x. Finally, the curve B(x) represents the total of the contracting cost and the agency cost. The optimal cost associated with defining the contract will be agreed by all agents to be at the point B(x*), although the contract still remains incomplete. This category of incomplete contracting

models considers that it is costly to write elaborate contracts and therefore there is a need for *ex post* governance.

But incomplete contracts allow agents the discretion to make decisions for the principal that are based on individual expertise and professional judgement, although these may seriously reduce any bargaining power held by shareholders over managers. This follows directly from the fact that an incomplete contract does not foresee all the contingencies relating to the obligations and outcomes that may arise, even to the extent of the manager taking all the residual rights of company. Given the power of the discretion accorded the manager, appropriation can be deliberate and shareholders are less able to acquire fundamental information about the firm they essentially own.

Agency Theory and the Separation of Ownership and Control

To explain the origin of the agency problem, two aspects of managerial motivation are presented by Jensen and Meckling (1976) that result in conflicting outcomes for shareholders. The first are pecuniary benefits, including salary, performance bonuses, shareholding, etc., all of which work in the interests of shareholders as well as managers. The second are non-pecuniary benefits that arise from the discretionary power of managers and include opportunity to extend personal contacting networks, and the trappings of power that are usually detrimental to the value of the firm. These are essentially incompatible with each other. Therefore, in order to maximise total personal interest, the manager aims to balance these two sets of incentives.

Where the manager only owns a partial share of the firm, there will be an imperfect trade-off for the manager between pecuniary and non-pecuniary consumption. The pecuniary benefits of managers under the circumstances only align with firm value up to a proportion of their shareholding . In order to maximise personal interest in total, the manager will place more emphasise on non-pecuniary rewards. Consequently, the value of the firm will be sacrificed,

and the remaining shareholders will bear the loss of wealth.

An obvious question is why does such a part-owned corporate structure exist, that is, why are all firms not owner-managed? Jensen and Meckling suggest that since entrepreneurs cannot always provide sufficient support for growth and expansion, external financing is unavoidable. However, the agency problem does limit firm growth and the benefits of external financing will be counteracted by the increased costs discussed in the previous section.

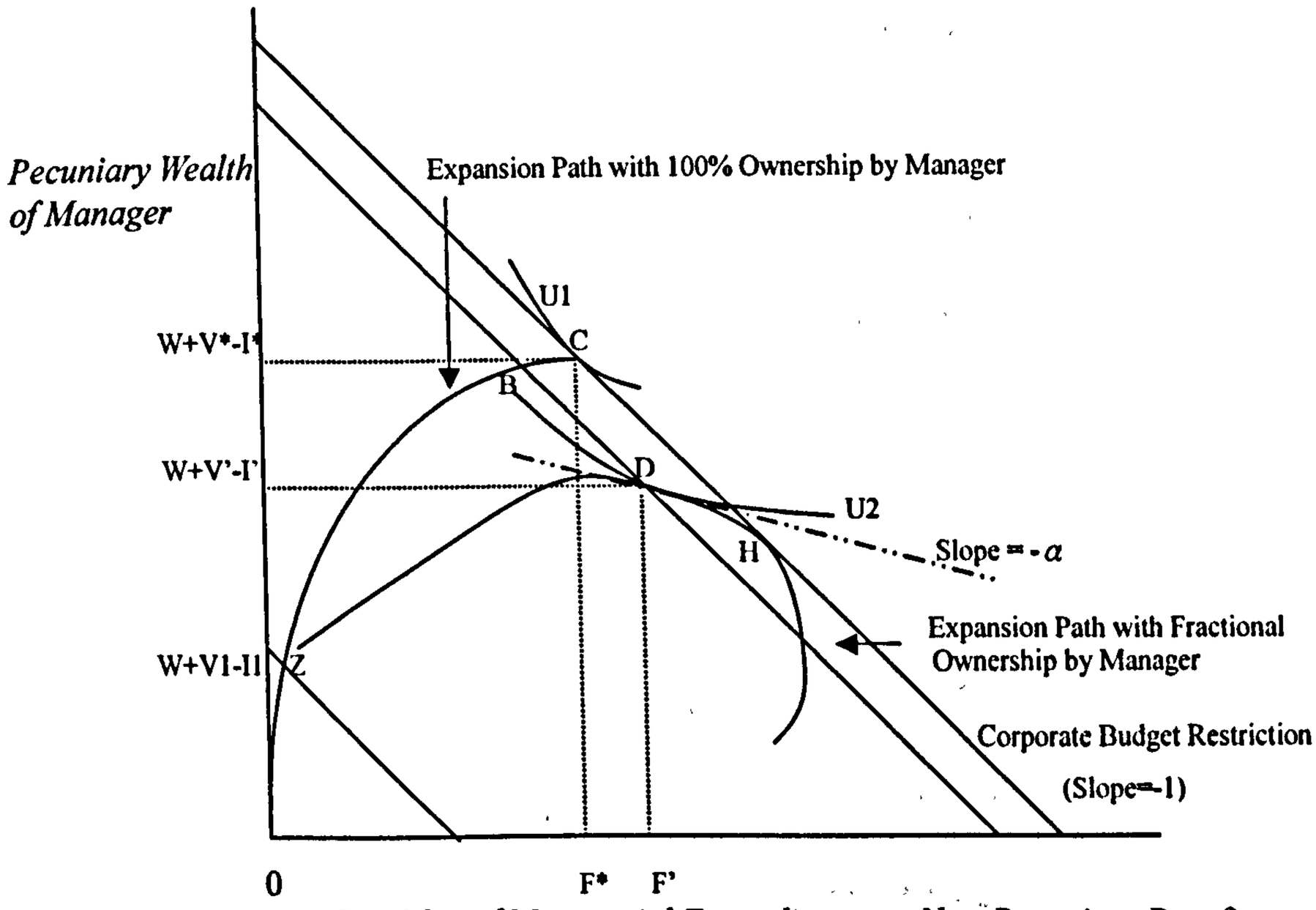
A dynamic model illustrating agency factors problems as firms expand is proposed by Jensen and Meckling (1976). In Figure 2.2, the horizontal axis represents the market value of managerial expenditures on non-pecuniary benefits and the vertical axis represents the pecuniary wealth of managers, where pecuniary wealth equals the initial wealth, W, and the net value of investing, that is the value of the investment V minus the cost of I.

In the owner-managed firm, the trade-off between the consumption of pecuniary and non-pecuniary benefits will be perfectly correlated, resulting in a negative slope to the managers' consumption line. Under this circumstance, the curve OZBC in Figure 2.2 represents the locus of optimal managerial consumption allocation from two sources of benefits at each possible firm size along the expansion path. For example, for the expansion scale in the cost of I*, the optimal managerial consumption will be point C where the private consumption line of the manager with slope (-1) is tangent to the highest indifferent curve U1. There, the manager is consuming F* units of non-pecuniary benefits and achieving personal pecuniary wealth W+V*-I*.

However, private finance by managers is limited, and if external resources are necessary for corporate growth after the cost I1, the locus of optimal managerial consumption allocation no longer follows OZC. Rather, the locus past the point Z (responding to the cost of I1) will follow the curve ZDH, which is determined by the various consumption possibility lines of managers in firm of different scale. Specifically, the slopes of the managerial consumption lines are determined by the proportion of managerial ownership - the proportion α ($0<\alpha<1$) of

shareholding achieves the slope of $-\alpha$ in consumption. When the lines tangent to the highest indifference curves along the budget constraints of the firm, the optimal consumption allocations between the two benefits are fixed.

Figure 3.2. Agency Theory and Firm Growth



Source: Jensen and Meckling (1976), pp. 320.

With the ownership share of the manager gradually reducing, corporate expansion is constrained at the size of firm at point D, if the *ex post* monitoring activity is not available. At this point, the locus of managerial optimal allocation between the consumption of the two sets of benefits is at the highest indifference curve, U2 - further growth will rather lower managerial interests on this. Comparing the two expansion paths between the owner-managed firm and the part-owned firm, the vertical difference represents the agency costs of firm growth.

However, after purchasing shares from the owner-manager, rational investors are likely to engage in governance activity *ex post* to constrain managerial consumption of non-pecuniary

benefits to an agreed level. In practice, there are many methods used by shareholders to monitor or discipline managers, such as audit, budgetary restrictions or incentive contracts. However, attempts to monitor the agency relationship are not free. Jensen and Meckling (1976) argue that when the monitoring expenditure of shareholders is anticipated, a bonded contract matching the monitoring activity will be agreed by the manager. As the result, the manager not only achieves the highest utility but also acquires the additional monitoring costs presumed by shareholders. Accordingly, any cost arising from monitoring activity is included in agency costs.

Jensen and Meckling (1976) define the cost of agency problems to be the sum of (1) the monitoring expenditures by the principal, (2) the bonding expenditures by the agent and (3) the residual loss (p. 308). The residual loss is referred to as the reduction of corporate value when the firm is run by a fractional-owner compared with the fully-owned management model.

Corporate Governance – Strategies to reduce Agency Costs

Given that managerial knowledge and expertise is essential to remaining competitive, Jensen & Meckling (1976) discuss the practicality of governance arrangements to minimise losses resulting from agency conflict. Following from the theory developed in the earlier section, it is clear that the higher the level of managerial ownership the less the problem of miss-appropriation. In the extreme case, when firm ownership is fully concentrated in the hands of the manager, the conflict disappears and the moral hazard eliminated.

Johnson et al. (2000) summarise the effect of management ownership concentration to address the agency problem in a mathematical model, suggested by Jensen & Meckling (1976). In this model, a manager owns a share in the firm, α, with the remaining share, $(1-\alpha)$, dispersed to outside outsiders. The value of retained earnings for this company is I and the value of managerial expropriation of these earnings is S, where $S>0$. However, if the managerial expropriation has been noted by the outside shareholders, the manager is dismissed. Thus,

equation 2.1 predicts that the managerial expropriation on S carries a personal risk to the manager of $(\frac{S^2}{2\times\kappa})$ if caught. The sign on κ denotes how sensitive and efficient the external shareholders are to monitoring and acting on poor behaviour by managers. Therefore, the value of κ is negatively associated with the quality of the institutional environment in protecting shareholders rights. Poor institutional protection leads to a larger value of κ and results in lower cost due to managerial expropriation of S. However, apart from the expropriated amount, the remainder of retained earnings from I are continually reinvested in subsequent projects and the gross rate of return for these is denoted as R in equation 2.1. Since the manager pecuniary benefit is still a function of reinvestment in projects and the return earned on the owned share, α, the manager will ensure the gross return rate R is positive. This results in the sum of the pecuniary benefits from investment and the amount of expropriation of retained earnings being the total gain to the manager:

$$MaxU = Max\{\alpha R\times(I-S)+[S-(\frac{S^2}{2\times\kappa})]\}\ ;\ \alpha,\kappa,I,S\geq 0;\ \mathrm{R}>0 \qquad \textbf{2.1}$$

Differentiating 2.1, the optimal amount of managerial expropriation, S^*, gives

$$\frac{\Delta U}{\Delta S}=1-(\frac{S^*}{\kappa})-\alpha R=0 \qquad \textbf{2.2}$$

and solving S^* yields the optimal expropriation amount

$$S^*=\kappa\times(1-\alpha R) \qquad \textbf{2.3}$$

Further, differentiating the optimal expropriation in 2.3 with respect to α gives

$$\frac{\Delta S^*}{\Delta\alpha}=-\kappa R \qquad \textbf{2.4}$$

Equation 2.4 expresses the negative relationship between managerial expropriation and the extent of manager shareholding. If the values of κ and R are fixed, a higher level of ownership concentration will force managers to lower their optimal managerial expropriation $S^{\bullet}$, in order to maximise total benefits.

Jensen & Meckling's (1976) claim that ownership concentration by managers can effectively deal with the agency problem has inspired studies that search for feasible ways to limit managerial appropriation. The central theme is that through the construction of a governance mechanism, it is possible to turn management effort towards maximising firm value and various governance arrangements attempt to provide an efficient way to control agency relationships.

The Empirical Literatures on Agency Problems

Agency Problems in Practice

The seminal work on corporate governance by Jensen and Meckling (1976) has shown theoretically that the separation of corporate ownership and control causes conflicts of interest between principal and agent. Following this, a vast amount of empirical literature tests this relationship, in particular, relating to the question of the gap between the benefits managers extract for their private consumption and the impact this may have on the value of the firm. Denis (2001) illustrates the identification of agency problems in practice, presenting three main findings.

The first is that senior managers appear to have a strong desire to remain in power (see: Amihud, 1981; Charreaux, 1997; Coleman, 1988; McEachern, 1975). However, given the dynamic nature of the commercial environment, the characteristics required of managers to retain an advantage over rival firms differ as situations change. Therefore, frequent management changes would be expected and necessary for a modern business. But, clearly

incumbent managers are generally unwilling to lose their controlling rights and attempt to block any attempt to adjust to new situations by changing personnel. One way for manager to stay in power is to entrench their position by adjusting levels of output or blocking the disclosure of information to outsiders. Thus, a manager that is inappropriate in a given set of conditions that is able to manipulate the environment in order to stay in power presents an agency cost to the principals. The work of Vecchiolla et al (1998) illustrates the defence tactics that managers can choose to adopt to entrench the firms' controlling position and block any potential acquisition, regardless of the views of the shareholders. The argument continues by noting that if a manager wants to put the defence strategy to a shareholder vote, they can do so, however, most managers choose avoidance tactics that do not require shareholders' approval. This indicates that self-interest on behalf of managers is a major motivation for entrenchment rather than being a strategic decision on the part of the firm.

Secondly, managers tend to be risk averse and hesitate to act in response to environmental change (see: Hill and Snell, 1988; Hill and Snell, 1989; Hoskisson et al., 1993; Hoskisson and Johnson, 1992). Compared with shareholders who hold well-diversified portfolios, managers put all their effort into one firm. Therefore, the failure of a single company, although reducing the wealth of shareholders has more impact on the wealth of managers. Further, failure of the firm can destroy the professional reputation of the manager and reduce the changes of finding alternative employment. This may bias the manager in the choice of investment projects undertaken and the best potential opportunities may be disregarded in favour of a lower risk, lower return option. Conversely, a well-diversified shareholder would prefer the company to proactively invest in all projects with positive return, and managerial conservatism regarding investment policy conflicts with the wishes of shareholders. On the other hand, reluctance to respond external change can cause bias in project evaluation decisions, resulting in a tendency for firms to continue to pursue failing projects (Brockner, 1992). A large body of research supports the view that agency problems are an important set of conditions that lead to an

escalation in this commitment to failing projects (see: Rutledge & Karim, 1999; Harrison & Harrelle, 1994; Harrelle & Harrison, 1993). With this potential for conflict between the interests of managers and shareholders, managers are likely to adhere stubbornly to their own experience of safe projects, often contrary to the views of shareholders.

Thirdly, managers prefer to retain free cash flow within the firm (see: La Porta et al, 2000b; Jensen, 1986; Jensen, 1993; Rubin, 1990). Jensen (1986) defines free cash flow as the cash generated from operations in excess of the funds required to support all available projects with a positive return. If there is surplus cash, there are three uses to which it can be put: to pay it back to shareholders (dividends), to reinvest it in existing or new projects or keep it as retained earnings. The first choice of the shareholders would be a dividend payment to shareholders who can use their increased wealth in a way that maximises their personal utility, particularly since the claim on residual interests is theirs by right. The second best choice would be reinvestment in positive return projects to expand the company and maximise the value of the firm. However, retaining the earnings in the firm is frequently the course of action followed. The potential return to managers through higher salaries redirects free cash flows from the principal to the agent, and is clearly costly to the providers of capital (see: Lehn and Poulsen, 1989; Agrawal and Jayaraman, 1994; Lang, 1991). In reality, it is difficult for outside shareholders to tell whether retained earnings are used for positive return projects or for the personal ambition of managers.

Evidence of Agency Problems – the Impact on Strategy Decisions

In the last two decades, numerous empirical studies have revealed evidence of agency problems, and how this impacts on the strategy decisions of the firm. Using a sample of acquired companies, Ryngaert (1988) tests whether the decision by managers to adopt takeover resistance strategies is in the interests of shareholders. Using a sample of 380 US firms, it was found that such strategies were significantly related with a fall in the share price. Moreover,

when the potential acquirer challenged this behaviour in court, a ruling in favour of the target company again lowered the share price, whereas a ruling against the target raised the share price.

However, the study also found that such defensive strategies were not effective in all hostile takeovers, but only those arising from unsolicited bids in tender offers. As a bidding contest usually increases the stock price, shareholders should welcome it. But, when the defensive strategies are successful, the contest for ownership ceases and the share price no longer rises and the takeover premium disappears. Thus, the study concludes that defending a takeover is a strategy that enhances the manager's position of entrenchment in retaining controlling rights but is detrimental to shareholder value, and is clear evidence of an agency conflict.

As well as being a defence strategy for target-company opposition to a takeover, Trillas (2001) provides evidence that agency problems can also arise in the investment decisions of bidding firms. An example is that of Endesa, the largest electricity company in Spain. This company initially expected to take control of a major Chilean conglomerate in a bid valued at US$ 1500 million. However, after a long process of negotiation from 1997 to 1999, the final price was settled at more than US$ 5000 million. Moreover, ex post, the transaction did not create value for the shareholders, rather was a classic example of the free cash flow theory. When no positive net present value project is available, managers waste resources on subordinate expansion schemes instead of distributing the funds to investors. The paper argues that the firms with weak control systems are relatively unconstrained financially and will be more likely to pursue transactions that do not create value at all.

Shleifer and Vishny (1989) also discuss the problem of managerial entrenchment and obstructing management turnover. This study presents a model that illustrates how an incompetent manager can remain in power if their position can be effectively entrenched by undertaking a particularly successful project and making this public information. This single

success can shift the balance of power and may convince shareholders that they agree to a higher salary or benefits and remain in position. The incompetent manager will concentrate on entrenchment strategies rather than other projects to increase the value of the firm.

Jensen (1986) uses an example from the oil industry to test the attitude of managers toward firm free cash flows. During the 1970s, the oil price increased tenfold and subsequently generated huge excess returns. At the same time, the trend in oil consumption globally began to fall and the market anticipated price declines in the future, putting an end to the excess profits in the sector. Although revenues remained high, the sector was concerned that crude oil reserves were limited and it was important to undertake further exploration and development. However, the huge free cash flows generated from existing operations were not returned to shareholders, not invested in R&D, but rather were used to launch extensive diversification programmes and much of the free cash flow was directed outside the oil industry. Unfortunately, without the expertise and experience in other sectors, these programmes were largely unsuccessful. This is another example of managerial decisions that directed cash flows away from shareholders or positive return projects but were appropriated by managers towards projects that had a lower probability of success. The study concluded that a company with excess cash flow but the lack of desirable investment opportunities presents a serious problem in the agency relationship.

Jensen's (1986) work implies that when the environment is expected to be unfavourable in the future, managers tend to adopt diversification as a solution for growth although this may simply be a strategy to retain free cash and entrench their position. Compared with a strategy that builds on internal expertise and comparative advantage, diversification can complicate operations and cause more difficulty for the firm.

Comment and Jarrell (1995) examine how a focused investment strategy impacts share prices and also contributes to the literature on the links between diversification strategies and the use of corporate resources. The paper finds a reversal in the US trend of increasing diversification since the 1950s to a more focused strategy from the late 1980s. A cross-section

study found a positive relationship between a focused strategy and stock returns, hence increased shareholder wealth. Their analysis reveals that diversified companies did not significant outperformance compared with more focused firms, and were more likely to be the subject of hostile takeover. This not only challenges the profitability of diversification but also provides evidence of an agency problem.

Building on Comment and Jarrell, Denis et al. (1997) provides further direct evidence of the agency costs of diversification. With a sample of 933 US firms, the paper tests the link between managerial ownership and firm diversification, finding a strongly negative relationship, despite controlling for other factors related to diversification. However, in the presence of outside block shareholders with the ability to monitor management effectively, the extent of firm diversification is reduced dramatically. This finding directly links the positive effect of agency problems to strategic focus strategy.

Dividend payments are the most direct way for managers to return excess cash flows to the legitimate owners. The work of La Porta et al. (2000b) tests whether the quality of the agency relationship can explain the range of dividend policies globally. Two alternative hypotheses are tested. The first argues that dividend payments are made because minority shareholders can effectively coerce managers to distribute free cash flows. The second considers dividend payments are made because the manager intends to issue more equity in the future and pays dividends in advance to establish a reputation for fair treatment to minority shareholders. As both of these hypotheses imply the dividend payments are subject to the conflict and the symbiosis in the agency relationship. An international sample of 4130 firms from 33 countries found that where the legal system provides better protection of shareholder rights, making the shareholders more powerful and able to bargain for residual rights with managers, firms pay higher dividends. On the other hand, in circumstances where firms are growing fast and dividend payout is low, it is only in those countries with high levels of investor protection that shareholders are prepared to wait for dividend payouts until the firms have become well

established. In these situations, it is clear that shareholders are more confident with the agency relationship. Thus, the findings support the first hypothesis that the bargaining power of shareholders is a critical element of dividend policy, plus a non-opportunistic agency relationship is important for the long-term growth of firms.

Corporate Governance in East Asia

With the exception of Japan, much corporate governance research relating to East Asia is based on case study methods that discuss the characteristics of specific business communities. Although these studies yield a number of interesting and significant findings, such as confirming that businesses depend largely on the privileges granted by local government to protect domestic market from foreign competition, the picture of corporate governance remains unclear. Until the 1997-8 financial crisis, systems of corporate governance mechanism in East Asia had been neglected and there was limited research on the issue. However, since the crisis, this has attracted more attention.

One example is that of Johnson et al (2000), which is based on the legal protection aspects of governance and argues that poor legal protection for shareholders is responsible for the financial crisis in East Asia. The corrupt institutional environment led to the currency depreciation and stock market decline in East Asia countries and inadequate governance mechanisms rather than macroeconomic variables were much more damaging to the general economic welfare of these countries. Johnson et al. argue that in an environment with poor investor rights protection, agency conflicts are exacerbated and instances of managerial appropriation proliferate. At the same time, outside investors in East Asian countries fundamentally distrust the integrity of managers and any investment that does take place is based on the expectation of growth in an emerging market rather than the fundamentals of the company itself. Once their expected returns begin to look less certain, funds are withdrawn from the region altogether, due to a general lack of confidence. Therefore, during a recession

period, such as the financial crisis, investors move to a more certain environment and one with governance mechanisms they recognise and understand.

Work by Mitton (2002) adds to the literature on understanding the role of corporate governance in the East Asia financial crisis. Contrary to that of Johnson et al. (2000), which focuses on the governance effect of national institutions and focuses on the national economic recession, Mitton conducts a firm level analysis to examine whether corporate governance factors are still meaningful to performance during the crisis time. Based on firm data from five crisis countries, the paper tests whether companies with good corporate governance outperform others, even during a crisis, and find that they do. Companies with better monitoring mechanisms, including audit by one of the big-six accounting firms and higher levels of ownership concentration held by outside blockholders, deteriorate significantly less than those that do neither of these. Further, this work reveals the performance of diversified firms is significantly worse than those that focus on core activities, despite the possible benefits of diversification during economic uncertainty.

Given the importance of corporate governance in the region, a study by Claessens et al. (2000) further discusses characteristics of firm ownership in nine major East Asia countries. The paper finds that more than two-thirds of the listed-firms in East Asia are ultimately owned by the largest single shareholder. Moreover, among these companies, 60% of the management board places are held by family members from the majority shareholding family, making the companies in East Asian countries controlled by the family of the largest owner. Another finding is that the controlling families in this area largely use pyramid structures and cross shareholding among corporate subsidiaries to enhance their control. Depending on these particular ownership arrangements to leverage up the share of family shareholding in the corporate ownership structure, large amounts of shareholding is not necessary for the controlling family in East Asia to achieve corporate control. Consequently, the different levels of interest between corporate ownership and control will directly motivate further managerial

expropriation by the controlling family.

Given this finding about the structure of ownership in East Asia, it is clear that agency conflicts existing in this region are of the principal-principal basis (Young et al, 2002) - between the controlling family and minority shares - rather than the agent-principal relationship suggested by Berle and Means (1932) and Jensen and Meckling (1976) in Western countries. Furthermore, in the West, most publicly traded firms are highly diversified and family firms are small. However, in East Asia, the family of the largest shareholder commonly play a determinant role in the management of a public-listed company, such as in South Korea (Jung and Kwon, 2002), Hong Kong (Ho and Wong, 2001), Singapore (Mak and Li, 2001), Malaysia (Piesse and Khatri, 2002), Thailand (Dhnasirek and Tang, 2003; Suehiro, 2001) and Taiwan (Yeh et al, 2001). The difference impacts any study of corporate governance by presenting a challenge for the applicability of traditional models on this specific context of public-listed but family-controlled firm.

Corporate Governance Mechanisms

Categories of Corporate Governance Mechanisms

To confront the threat of appropriation, the shareholders may construct various governance mechanisms to protect their own interests, defined by Jensen (1993) in four general categories. The first are the legal and regulatory mechanisms. In theory, a shareholder willing to finance a company has a contract that gives them the right to residual claims. If this is violated, the shareholder can appeal to the court. Thus, legal protection for shareholders is a basic governance mechanism and is fundamental to the structure of the contemporary firm.

In contrast, the second category describes those mechanisms that apply within the firm. These include monitoring managerial performance and disciplining failing managers and are the responsibility of the board of directors. Therefore the composition of the board, compensation schemes for manager and the specific arrangements with respect to ownership

structure are all instruments that are pertinent to internal governance. These can be criticised proactive and disaffected shareholders who can bring about change if there is sufficient coherence.

The third category relates to mechanisms that are brought about by external pressure, which challenges managers controlling rights. This is generally the result of an external bidder who considers the firm could be more profitable, perhaps because of poor governance by the incumbent management. Regardless of the result, the bid is a signal that there may be a problem within the firm and shareholders will be in a better bargaining position to negotiate an improved distribution of residual rights.

The final category of corporate governance mechanisms arises from competition in the product market. In a competitive environment, a manager with a high consumption of non-pecuniary benefits will induce slacks in productivity, the firm will no longer be competitive and the share prices will fall. This will make raising further capital difficult, or result in bankruptcy.

Jensen (1993) suggests that product market competition is a blunt instrument in the fight for effective corporate governance. He argues that the impacts of market competition come slowly, and a great deal of firm value can be further lost when waiting for the governance effect to materialise. With this concern, it is not common for empirical studies that test market competition as an efficient governance mechanism. On the other hand, Holmstrom and Kaplan (2001) argue that hostile take-over achieving slowed after the 1980s, and the importance of external discipline on corporate governance is reduced. In particular, with the characteristics of ownership concentration and pyramid shareholding structure, the possibility of external parties successfully challenging managers controlling rights is low in most East Asian countries (see: Mak and Li, 2001; Dhnadirek and Tang, 2003; Suehiro, 2001; Jung and Kwon, 2002; Piesse and Khatri, 2002). Therefore, the governance mechanisms depending on the external pressure of merger and acquisition (M&A) can be inappropriate to corporate governance in this region.

The categories of governance mechanisms pertinent to the empirical analyses of this thesis are discussed in the following section.

Legal and Regulatory Mechanisms

The introduction of a legal system in any country is an evolving process, generally arising from, and reflecting, a particular set of cultural and traditional histories. Most contemporary commercial law has its origins in one of two main systems: English common law and Roman civil law. Civil law origin can be further divided into three major groups, French, German, and Scandinavian and the vast majority of legal systems originate from one of these four. La Porta et al. (1998) test how these four legal groupings differ in investor rights protection, using data on publicly traded firms in 49 countries. Having divided the sample into four groups matching their legal origins, they compare the strength of investor protection. Their results show that the common law group has higher protection of investor interest than any of the civil law group. Further, within the legal family of civil law, the German and Scandinavian systems perform better than the French. However, differences also exist between types of investor, although investors and creditors were afforded some rights under all four systems.

In addition to the existence of regulation at all, the quality of enforcement is central to how effective a governance mechanism is. This is also addressed by La Porta et al. (1998), who find an interesting difference in the rankings of legal systems from the results above. Here, German and Scandinavian civil law have high levels of enforcement in common, with the French and English common law less effective. In addition, they found that the quality of legal enforcement improves significantly with increases in income level.

The final finding of La Porta et al (1997) shows that country specific differences can influence the effectiveness of the legal system in constraining managerial appropriation. A further study by La Porta et al. (2000a) considers how different legal systems protect investors' rights for both shareholders and creditors. Where there is an ineffective system of legal

protection for investors, there will be an understandable reluctance to enter the local market. Where growth is dependent on the participation of general investors, and financial markets are crucial for the development of local firms and economies, governments are urged to improve legal system. The research advocates that looking for efficient mechanisms of legal protection is a valuable factor in establish robust systems of corporate governance.

Ownership Structure as a Governance Mechanism

Following the argument of Jensen and Meckling that managerial ownership concentration may be effective to control agency cost, researchers have studied the impact of governance mechanisms. However, the results provide support for different effects depending on the characteristics of ownership structure.

One example is based on a sample of 371 Fortune 500 companies in 1980. Morck et al. (1988) test the relationship between managerial ownership and corporate performance, measured by Tobin's Q. In this paper, the definition of managerial ownership is referred to the shareholding of all the board members holding shares greater than 0.2%. The results show that the governance effect of managerial ownership on corporate performance presents a non-monotonic relationship rather than a simple linear one predicted by Jensen and Meckling (1976). This analysis suggests that the positive governance effect is only sustained for managerial shareholding of between 0 to 5 percent or more than 25 percent. When managers own between 5 and 25 percent, the governance effects of managerial shareholding is negative.

A contrary finding using a sample of more 1000 firms, McConnell and Servaes (1990) emerges from a re-examine of the governance effect between managerial ownership and Tobin's Q. Here, the managerial ownership is defined as shares owned by all corporate insiders including CEO, board directors and other senior managers. As with the different pattern of governance effects found by Morck et al. (1988), this study indicates that Tobin's Q is consistently positively influenced by insider ownership levels where these are low, but has a

positive effect where holdings are greater than 5%. The study goes on to test the governance effect of outside blockholder ownership and finds this has a positive but insignificant effect on Tobin's Q.

A later study by Cho (1998) re-examines the governance effect of insider ownership and Tobin's Q, revealing a non-monotonic relationship in the governance effect similar to the relationship found by Morck et al. (1988) and opposite that by McConnell and Servaes (1990). However, Cho also examines the causality between corporate performance and ownership and finds an unambiguous direction of causality, with insider ownership a function of Tobin's Q and Tobin's Q a function of insider ownership. This conflicts with the uni-directional causality from Tobin's Q to insider shareholding found by Jensen and Meckling (1976) and others.

Endogeneity in Governance and Ownership Structure

The contradictory findings with respect to the governance effects of insider shareholding indicates that more care is needed in conducting empirical tests of the underlying relationships. An early study of corporate governance by Demsetz (1983) suggested that endogeneity was a major concern, arguing that firm ownership structure develops from a process involving the self-interested behaviour of shareholders and the influence of the market on share price. Demsetz claimed that regardless of the pattern of ownership, when external financing is required the most likely outcome is that managers actively manipulate insider shareholding in order to make the firm more attractive to prospective fund providers. Furthermore, where there is a hostile bid for the firm, each side will attempt to accumulate the maximum level of shareholding possible to them. However, this implies that patterns of ownership are achieved by circumstance, rather than as a result of governance mechanisms, and simply reflect self-interest maximising behaviour.

Further work by Demsetz and Lehn (1985) use a sample of 511 US firms from a number of sectors to investigate whether firm ownership patters are endogenous to the firm. Contrary to

much research on the impact of insider ownership on Tobin's Q, this study measured firm performance by accounting ratios and tests how these are influenced by the distribution of ownership. In addition, to capture any endogenous factors, two stage least square methods were used to estimate rather than ordinary least square techniques. Results confirm the earlier Demsetz study, and no significant governance factors were detected in the relationship between ownership structure and corporate performance.

Again following Demsetz and Lehn (1985), analysis by Himmelberg et al. (1999) assumes ownership structure is endogenous. The study included a number of firm specific characteristics, such as size, capital intensity, R&D intensity, advertising intensity, cash flow, and the rate of investment, all of which could be expected to have a potential agency conflict. Estimation was by panel estimation, with fixed effects to control for the endogenous relationship between managerial ownership and corporate performance and Tobin's Q was again the dependent variable. This study confirmed the findings of Demsetz and Lehn (1985), that is, after adding the fixed effects to control for the change of unobservable firm level characteristics, changes in managerial ownership pattern do not significantly affect firm performance over time.

The methods used by Himmelberg et al has been challenged by Zhou (2001), who considers that by adopting the fixed effect estimators from the panel data analysis to control for endogeneity, the identification of any existing relationship between ownership and performance was invalid. Zhou claims that the fixed effect estimators are mainly used to exploit the differences within individuals, which removes all cross sectional effects between variables. If the pattern of managerial ownership differs substantially between individual firms and this difference does effect firm performance, the significant effect of ownership and firm performance will be eliminated. Because of this, Zhou predicts that it is not surprising that the fixed effects model failed to detect a significant governance impact on insider shareholding. Rather, the governance structure may evolve slowly from year to year within a firm and

therefore it is a common phenomenon that the changes in the corporate governance structure will not be observed with a limited period and any significant impact on individual firm performance will only be detected in the long term.

Endogeneity problems may be not fatal for in a corporate governance study but it does require careful model design and estimation. Methods to identify and testing for the presence of endogeneity and subsequently instrumental variable estimation is necessary in order to obtain unbiased and consistent parameters.

Board Characteristics as Governance Mechanism

Tests of the effect of board characteristics on corporate performance have been done by a number of authors. In theory, the board director has wide power to influence firm decisions as well as monitoring activities by managers, as suggested by Jensen and Meckling (1976). However, the various board characteristics, such as size, share ownership and composition can have a significant influence on efficiency and monitoring, both of which contribute to levels of performance.

Intuitively, monitoring is more effective where a larger proportion of members are independent or outsiders. Brickley et al. (1994) tested this hypothesis on a sample of 247 firms that had been the subject of a hostile bid between 1984 and 1986. The positive effects of resisting the bid on there firms were doubtful, particularly compared with the evidence that on managerial expropriation in this situation, found by Ryngaert (1988) and discussed above. Resistance strategies are usually the decision of senior management and shareholders are not consulted. Thus, if the responsibility of outside directors is to protect shareholder interest, where there is a higher percentage of these on a board, decisions are more likely to be made with that responsibility in mind. If the bid is hostile to management but is in the best interests of shareholders in terms of increased firm value, it is less likely to be opposed where the composition of the board is weighted towards outsiders rather than insiders.

Extending this hypothesis, the study found that as the percentage of outside directors on the board diminished the market reaction to the defence of the hostile bid becomes less supportive. Thus, from a positive market response where there is confidence in the outside directors, this becomes negative as their share decreases, with 26.5% being the cut-off point.

Xie et al. (2003) examines the effectiveness of independent members of the board of directors in preventing earnings management. Earning management is the manipulation of accounting measures that can present a conflict between principal and agent. Where managers can influence reported results, external shareholders can be mislead by the disclosure of information and subsequently make decisions based on this poor data. Agency costs can be exacerbated where managerial compensation is based on reported financial performance. Again, the presence of independent board members with corporate or financial backgrounds are associated with better monitoring and will lower discretionary payments listed in the financial report. On the other hand, an active board, which meets frequently, is also associated with lower levels of discretionary payments, again suggesting that the board does perform a monitoring function.

The size of board has also been shown to affect the quality of monitoring. While a larger board may well be better as a monitoring mechanism, this advantage can be offset by the incremental cost of communication. Yermack (1996) investigated the impact of board size on firm performance. Using panel data from the 792 largest US firms from 1984 to 1991, the study used OLS in a number of models, regressing Tobin's Q and other performance measures on board size and several controls including company size, industrial experience of board members and board equity ownership. Tobin's Q falls steadily as board size increases in the range from 4 to 10. For boards greater than 10, there is a positive effect on Tobin's Q. In terms of the alternative performance measures, results show these also deteriorated rapidly between board size 4 to 10 and then remain negative but fall much slower about board size 10. In addition, this research finds that the presence of non-executive chairman and a separation

between chairman and chief executive officer, significantly improves the valuation of these firms. In summary, the hypothesis that poor communication that is associated with a large board of directors negatively affects the quality of decision-making and leads to lower firm performance.

Critics of Board Characteristics as a Governance Mechanism

Not all authors find positive impacts associated with board size or composition. For example, Yermack (1996) considers external directors have little impact on the protection of shareholder rights. This is based on the empirical observation that while the average number of board members is increasing, and the share of the board held by outsiders is also increasing, there is no corresponding increase in firm value. This implies that the governance effect of outside directors is actually negative up to a particular size and then the sign changes. This finding by Yermack (1996) challenges the view commonly held by several researches, including Brickley et al. (1994) that outside directors can effectively resolve agency problems. Some of this criticism arises from the unresolved causality and endogeneity discussed earlier and much of the literature in the area concentrates on clarifying this ambiguity. One of the ways this is done is to examine the way that observable board characteristics have evolved into their current forms. Others directly link board characteristics to apparent governance outcomes, proxied by firm performance. The attempt to model the process can enhance theory and explain the governance effect of the board of directors more comprehensively.

A study by Warther (1998) constructs a model that considers corporate governance from the perspective of different board characteristics. This paper is different from previous corporate governance models, which simply consider the effects of corporate ownership and control. Rather, it models the cumulative experience of board members, such as tenure as a manager and their association with the firm from its establishment and their performance as directors, such as whether monitoring has involved votes to retain or dismiss the manager.

However, the model does claim that the votes of directors will be not purely based on the maximising firm value because, similar to managers, each director has a utility function, which is based on pecuniary and non-pecuniary benefits that are derived from board membership. Higher corporate performance and evidence of careful monitoring will raise the professional reputation of directors and enhance their own earning capacity. It will also raise share valuation and thus the directors' and shareholders' interests are aligned. However, where attempts to discuss a manager fail, the directors are seen as poor monitors and any benefits accruing to board members disappear. A high profile conflict between manger and board members leaves a legacy of poor monitoring and thus low standards of governance. Manager that are able to resist calls for dismissal are considered dominant and the firm's governance mechanisms weak. According to this model, the utility of board members is not perfectly aligned with the interests of shareholders. In order to enhance board effectiveness, Warther suggests an incentive scheme that rewards directors that insist on replacing an ineffective manager with a competent one.

According to Warther (1998) managerial power is a critical factor in determining the governance effect of board characteristics. Arthur (2001) provides evidence that managerial power can interfere in the process of deciding board composition. This study of 135 firms listed on the Australian Stock Exchange in 1989 tests the hypothesis that board composition is an outcome of bargaining process between the manager and the rest of the board. Results show that the CEOs of these companies was involved in determining board composition, with the number of outside directors inversely related to a series of proxies representing CEO bargaining power, tenure and shareholding. A further test of the impact of managerial power on board leader indicates that a CEO with a longer tenure or higher shareholding is more likely to be chairman of the board. Arthur confirms that the governance effect of board characteristics is neither monotonic nor uni-lateral with respect to compliance with shareholder preferences. Rather, there is an endogenous interaction among managers, shareholders and directors that combine to determine the composition of the board, resulting in an ambiguous impact on

corporate governance.

Conclusion

In this chapter, the theoretical and empirical literature on corporate governance is reviewed in order to provide a framework for the analysis that follows. The chapter begins with the definition of the agency problem and then goes on to discuss how conflicts between principal and agent arise and the impact this may have on firm value. The seminal work of Jensen and Meckling (1976) set out the early framework and the model is reviewed, in particular, to explain the impact on shareholder wealth from the violation of the agency relationship.

The empirical papers that are central to the literature and most relevant to this thesis are included, especially those identifying examples of managerial appropriation and the impact on strategic decisions. Further, since the basis of the thesis is an analysis of corporate governance in Taiwan, empirical studies of the East Asia region are presented. These are largely based on the 1997-8 financial crisis which exposed shortcomings in governance, which have been linked directly to family ownership and control and exaggerated by cross holdings and the low level of outsider influence.

Finally, the reviews of empirical agency relationship led to a discussion of the literatures on governance mechanisms, institutional arrangements and the rights of internal or external shareholders and how agency conflicts can be minimised. The legal system, ownership structure and board characteristics are presented as possible ways to contain bias and distortion, as well as some of the methodological problems that arise in modelling governance and control.

In summary, this chapter set up a framework for the empirical chapters on the impact of ownership structure and board control to draw upon. This provides a solid basis for the governance aspects of this thesis. The next chapter considers foreign direct investment and the links between these investment decisions and the system of governance with these firms.

Chapter Four: The Literature on Foreign Investment Strategy

Introduction

To test the effects of governance mechanisms, most of the existing literature uses firm performance as the measure of corporate governance outcomes. However, the relationship between governance mechanisms and performance is not necessarily direct but rather works through the improvement or deterioration in management quality. Indeed, using performance as a proxy may not reflect all governance related outcomes. Non-liner relationships between managerial ownership and corporate performance have been identified in several studies, for example, Short and Keasey (1999), McConnell and Servaes (1995), Kole (1995) and Morck et al. (1988), which may support an indirect relationship between corporate governance and firm performance. Moreover, for work linking senior management characteristics to firm performance, the empirical results are ambiguous (Priem, 1990; Michel & Hambrick, 1992; West and Schwenk, 1996; Keck, 1997). Carpenter (2002) argued that the inconsistent findings in terms of demographics and firm performance may be the result of previous studies that have overlooked important moderating or intervening variables. If this is so, the strategic context of firms is critical in determining a relationship between differences in senior management characteristics and firm performance.

Some studies have been successful in testing the effect of governance mechanisms on strategy adoption directly. For example, in the event study of firm diversification, it is argued that strategy adoption is though to be motivated by diversification that is the personal interest of managers involved with corporate operations (Amihud and Lev, 1981) resulting in a strategy that actually reduces corporate value (see Bhagat et al., 1990; Lang and Stulz, 1994; Comment and Jarrell, 1995). Empirically, a robust governance mechanism of high shareholding by top echelon managers, board directors and outside blockholders is proven to be associated with lower levels of corporate diversification (Berger and Ofek,1995a; Denis et al, 1997) and even

encourages the adoption of strategies that refocus following diversification (Berger and Ofek, 1995b). The findings of these studies not only validate the direct effect of governance systems on the value-reducing strategy, but also place the strategy decisions as the link between corporate governance effects and firm performance.

Explicitly, Howell and Stover (2002) question the appropriateness of methodologies that link corporate governance with performance. They argued that the seemingly significant effect on the relationship that had widely been found in prior studies might be caused by miss-specified models to deal with exogenous factors or failure to control for interactive effects among corporate governance variables. The problem can be caused by the indirect causality from corporate governance to firm performance, and thus the previous findings about the governance mechanism efficiencies on this relationship are should be re-examined within the strategic context of the firm.

With this concern, this thesis additionally tests the effect of corporate governance mechanisms on one of most important strategy decisions for the development of Taiwanese firms in recent decade, direct foreign investment (FDI). To establish a theoretical foundation for the following analysis, this chapter reviews the literature on corporate internationalisation. Furthermore, corporate strategy decision models and governance in the context of multinational enterprises, which are crucial for the link between internationalisation and corporate governance, are also addressed in this chapter. Finally, the relevant literatures for the two empirical issues on this topic are reviewed.

Corporate Internationalisation

Product Life Cycles in Global Corporations

Unlike the national welfare perspective of classical economics (the Absolute Advantage of Adam Smith, *1723-1790*, the Comparative Advantage of David Ricardo, *1772-1823*) and the

Hechscher-Ohlin theorem[1] that are used in the explanation of cross-border trades, the product cycle theory reflects firm level decisions. Product cycle theory was introduced by Vernon (1966) and adopts a more dynamic perspective to explain the process that firms set up production facilities abroad for products that had already been standardised and matured in the home markets. According to the theory, the internationalisation of firm follows three stages of the product life cycle. First, a new product is initially developed in the home country and serves foreign markets by cross-border trade. Second, the production technology is captured by competitors in foreign markets. To deal with the prospective challenges, the initial producer chooses to localise the production to consolidate its foreign market. This stage is import substitution. Finally, the stage of export substitution occurs when the production of the good has fully standardised, and price competition occurs. To ensure market position, manufacture is transferred to low-cost countries overseas and customers are served through the export market.

Compared with classical and neoclassical economics, the product life cycle theory provides an explanation of inter-industry trade and also addresses the issue of why individual companies engage in multinational investment and production. The Heckscher-Ohlin theorem highlights the importance of national resource endowment differences and suggests that these determine patterns of international trade. Furthermore, product cycle theory introduces knowledge as an independent variable in the decision for trade and multinational production; it argues that the dispersion of innovative knowledge from advanced to developing countries is the most critical factor determining a range of cross-border commercial activities. Vernon (1966) explains that although the possibility to gain access to scientific principles might be equal in all the advanced countries, the distance between the technology and its embodiment into a marketable product varies between countries. Since knowledge is imperfectly used in many countries worldwide, product cycle theory not only explains the reasons why multinational production occurs and is seen to be profitable, but also investigates the

[1] For further information, please refer to webside: http//internationalecon.com/v1.0/ch60/60c010.html

proliferation of multinational enterprises.

The International Operation of the National Firm

Another major contribution to the theory of international business was that of Hymer in a PhD thesis from MIT in 1960. Prior to the 1960s, the concept of multinational production was still immature and most economists simply treated the phenomenon of multinational investment by firms as the result of arbitrageur between countries, that is, capital is moving from a country with a low return to one providing higher returns. Hymer's thesis asserted that multinational investment of company involves the transfer of a whole package of corporate resources, not simply financial capital. Dunning and Rugman (1985) praised Hymer's contribution, stating that: *this was an escape from the intellectual straightjacket of neoclassical type trade and financial theory, and moves us towards an analysis of the multinational enterprise based upon industrial organisation theory* (p 228).

Hymer began with one of the fundamental concepts of foreign expansion by multinational enterprises, that a firm requires some form of advantage in order to operate and compete in an unfamiliar foreign environment. This view of the importance of acquiring competitive advantage over local rivals effectively underlies the assumption of many later works on multinational enterprise, such as that of Dunning (1977). To operate in a foreign market, the company will encounter competition from local firms, which are much more experienced in the operational environment than the outsiders. Without any means of overcoming this, the foreign firm has no incentive to locate in a foreign market or the ability to survive in it. The acquisition of competitive advantage can be achieved in a number of ways, for example, superior technology and knowledge, superior management and organisational skill, access to capital, economics of scale, access to raw materials, when one is discovered, an overseas firm can sufficiently enhance its ability to compete with the local competition.

With a greater comparative advantage, businesses will naturally extract whatever benefits

they can from an overseas market. However, Hymer argues that this alone does not fully explain the motive for multinational production. To explain the choices between multinational production and exporting, a number of "locational factors" should be considered. The original concept of location as a factor has grown in importance and is now used to discuss the behavioural models of foreign direct investment. For Hymer, the comparative advantages in multinational production push the firm to further foreign markets in the rush to expand. In contrast, locational factors within foreign countries attract multinational production, rather than encourage domestic production and then export to overseas markets. As with competitive advantage, a number of factors influence the locational choice of firms, such as, tariff and non-tariff barriers, policy of local government, idiosyncrasies of foreign market, and the significance of specific factors differ across industrial sectors.

As Dunning and Rugman (1985) indicated, the Hymer thesis was a serious addition to the theory of international business, although it has attracted some criticism. Dunning and Rugman (1985) expressed some doubts, claiming that Hymer did not fully appreciate Coase (1937), and thus failed to distinguish the sources of market imperfections that arise from structural and transactions costs (p 229). Dunning argues that Hymer's analysis was based on structural imperfections, which form the competitive advantage of multinational firm in term of cross-border trade. However, many of the conceptual imperfections arisen from Williamson-type transaction costs (Williamson, 1975) are completely ignored. Transactions costs arise from market imperfection between two countries, which are exogenous to organisational competitiveness. These market imperfections motivate enterprises to internalise multinational operations within the structure of the firm and thus improve the efficiency of market transactions. Following this route of multinational market internalisation, no economic rents would be anticipated by the firm. In contrast, the concept of competitive advantage according to Hymer is restricted to structural market imperfections where firms can gain from the process by exercising structural-cost power on multinational activities. Dunning and

Rugman (1985) criticises Hymer further, saying there is too little attention paid to locational factors in the decisions of multinational enterprise (p 230). However, overall, Dunning considers Hymer to be pertinent in the discussion of location in multinational production. Transactions costs that arise from market imperfections are discussed in the next section.

Transaction Cost Perspective for Multinational Firm: Internalisation Theory

In the Heckscher-Ohlin model, cross-border exchange is characterised by free trade, that is, perfect goods and factor market are assumed in which transport costs exist, consumers' tastes are identical internationally and there are constant returns to scale in production. Under these assumptions, global demand in the product market can be fully satisfied by cross-border trade and there is no reason or incentive for companies to engage in multinational production. Hymer initially challenged these assumptions, arguing that imperfections do exist in the global market and claimed that because of firm specific advantages there is a good reason to engage in overseas production. However, Dunning and Rugman (1985) highlight the importance of the missed transactions costs and suggests that a theory of internalisation that explicitly adopts the transaction cost perspective may be more valuable.

Although representing an incentive for foreign production, tariffs on imports present huge transaction costs for firms. Another distortion is the costs of securing intellectual property rights to avoid or delay corporate advantage being dissipated by products being copied by foreign agents. Transactional cost theory provides a different perspective on the reasons for the growth of multinational enterprises. An early paper by Coase (1937) sought to explain the boundaries of firm activity, although the focus of the study was on the multi-plant domestic firm rather than the international operations of firms. In this seminal paper, Coase argues that firm and market represent alternative methods to organise production. The firm produces through the organisational structure and the market functions through a series of transactions of intermediate goods that result in a final product. However, it is recognised that market

operations are frequently distorted by externalities that make the market costly and inefficient.

Coase noted four types of transactions cost in the market: the brokerage cost of finding a correct price, the cost of defining the obligations of parties in a contract, the risk of scheduling and related input costs, and the taxes paid on exchange transactions in the market. The existence of such costs means that when the transformation of intermediate goods to final product can be achieved with lower cost within a corporate structure than within the market, transactions relating to production will be internalised and undertaken by the firm itself. Firms will internalise the market transactions until the marginal cost of doing so exceeds marginal revenue.

Extending from the argument of Coase, Williamson (1975, 1981, 1985) further suggested that the transaction costs for a market can be examined systematically in relation to three factors – bounded rationality, opportunism and asset specificity. The bounded rationality refers to the individual limitation in learning all the information necessary to control for all possible contingencies in the future making the individual transactional decisions invariably sub-optimal. The costs of opportunism refer to the self-interest behaviour during the transaction process causing extra expenditure on monitoring and neutralising cheating, misrepresentation and negotiation. Asset specificity reflects the cost of necessary investments in terms of material and intangible assets to validate the transaction fully and also includes the cost of value loss in circumstance where agents adopt alternative sub-optimal methods to complete the transaction. Willamson argues that when the total transactional cost of the market from these three sources is too high, firm will have an incentive to replace the contract by an organisational hierarchy. For example, when particular equipment is necessary to conduct a specific transaction, the market contract requires additional expenditure to settle which agent in the transaction should be responsible for the investment beforehand and also to prevent opportunism by attempting to renegotiate the trading conditions afterwards. When the extra cost relating to the transaction is overwhelming high, there will be an incentive to internalise

the market transaction by acting within the firm.

McManus (1972), Buckley and Casson (1976) and Hennart (1982) extend the concept of internalisation to explain the existence of the multinational enterprise. For international markets the expectation is that the efficiency of the transaction is contingent on much more than simply cross border trade, since these transactions can be distorted more seriously by additional transitional costs. This raises the possibility for multinational enterprise to internalise cross-border transactions within the same organization and thus achieve more economic and efficient production. However, to internalise the transactions of multinational markets is extremely costly and a high return is required to compensate for the added complexity of these international operations. Compared with Hymer, this internalisation theory conceptualises multinational enterprises as institutions coordinating intermediate goods production in a number of countries to achieve final goods production in one specific country rather than force the company to produce the same product in different countries simultaneously. Moreover, the primary concern of internalisation theory is not how multinational enterprises exercise their competitive advantages over local competitors, but how the cross-border transactions are internalised within the same firm, rather than being conducted by means of international trade between independent firms.

Following this theory of multinational coordination, Casson (1987) uses internalisation theory to explain the patterns of both vertical and horizontal integration across national boundaries. Casson argues that the internalising process of multinational enterprise of the production of tangible intermediate goods explains the incentive for cross-national vertical integration, both upstream and downstream. Particularly, the incentive for vertical integration is contingent on the transaction costs that arise from the small number conditions. This is where the number of parties involved in the transaction is small, and arises from the need for physical asset specificity or specific expertise, which can cause difficulties in overcomes opportunistic behaviour during the transaction process. However, the internalisation of intangibles, including

knowledge and reputation globally, explains the incentive for cross-border horizontal integration.

Foreign direct investment (FDI) is one of the most important ways for enterprise to coordinate multinational transactions within a single internal organization. FDI occurs when a firm undertakes an investment in overseas assets, in which the investor retains a substantial degree of ownership and control and which fundamentally internalises that investment as a foreign affiliate within the corporate structure. According to the World Investment Report (2001), FDI has grown faster than world trade since the mid-1980s and is proof of the significant role of FDI in contemporary international commerce. In the modern multinational theories, internalisation is an enhancement, reducing market imperfections an providing an explanation for FDI activity. According to Rugman (1980), most existing FDI theories can be seen as sub-cases of internalisation theory (p 370).

The Resource Based Perspective of the Multinational Firm

Following internalisation theory the resource based view is the other most cited theory to explain foreign investment and multinational firm (Eisenhardt & Schoonhoven, 1996). The resource based view suggests that a combination of unique resources and capabilities within a company achieves its competitive advantage and thus shapes the strategy content of this firm to compete in markets (Hamel and Prahalad, 1994; Prahalad and Hamel, 1990). By contrast, a competence-based strategy of firm achieved by the resources combination helps the firm to achieve and maintain competitive advantage (Hamel and Heene, 1994; Itami and Roehl, 1987; Prahalad, 1998). The reasoning from a resource based perspective supports the arguments of Hymer (1960) that foreign expansion strategies of firms are motivated by their own competitive advantage.

The resource based perspective of the firm states that the firm's strategy and success accrue from its resource profile, developed and accumulated within the firm over time, not

those acquired externally (Pernrose, 1959). These resources are heterogeneous and immobile within the firm and provide unique services or attributes that are a source of economic rents (Collis, 1991; Dierickx and Cool, 1989; Peteraf, 1993). The resources may be bundled to form capabilities that lead to the strategic potential to exploit opportunities or neutralise threats from competitors (Amit and Schoemaker, 1993; Wernerfelt, 1984). Such unique resources and capabilities usually are the source of abnormal profits and thus linked to the competitive advantage of the firm. Barney (1991) states that: "*the sources of sustained competitive advantage are firm resources that are valuable, rare, imperfectly imitable, and non-substitutable*" (pp. 116). The resources and competencies achieving competitive advantage enable the firm to obtain a near monopoly position in the chosen markets (Rumelt, 1987; Prahalad and Hamel, 1990)

The resource based perspective recognises not only the potential for firm-specific resources to provide a competitive advantage, but also acknowledges that firms must maintain and continuously renew, augment, and adapt their competencies over time, if they are to retain a competitive advantage. Strategic choice is essential for a firm to enhance and foster the valuable resources and competences (Cohen and Levintha., 1990; Dierickx and Cool, 1989). Accordingly, the strategic decisions made by senior managers play an important role in leveraging corporate resources and seeking to accumulate or develop the necessary resources to retain competitiveness in the future (Prahalad and Hamel, 1990; Tyler and Steensma, 1995). Collis (1991) argues that the capacity of management for continuous renewal is contingent on the firms' ability to innovate, learn, and transfer information within and between the firm and its environment.

The resource-based perspective is primarily applied in the strategy field to explain firm-level performance resulting from idiosyncratic resources and capabilities. However, many studies have explicitly suggested that it is compatible with the rationale for cross-border investment (Fladmoe-Lindquist and Tallman,1994; Tallman, 1992; Hitt et al, 1997).

Specifically, by extending resource-based thinking to the international arena, it may be able to offer further insights into the rationale behind the deployment of firm-specific assets in foreign markets.

Moreover, resource-based view complements the argument of Hymer (1960) about the location attractiveness of the host-country (Trevino and Grosse, 2002). To attract foreign investment, host-country location must offer benefits to help investors overcome the inherent disadvantages of operating in an unfamiliar setting. By contrast, the unique resources and capabilities of investing firms must be matched to the host-country environment because of location-specific advantages, and then move to the foreign investment decision. In line with this argument, empirical studies have found a strong connection between global sourcing choices and foreign investment decisions and proved that the location advantage provided by global sourcing that achieves low-cost conditions of production, complements firm-specific resources in pursuing overseas markets (Park, 2000; Fladmoe-Lindquist and Tallman, 1994). This confirms that the foreign investment of firms is not only based on the motive of market seeking, but also on the strategic and economic aim to increase competitive advantage in domestic or international markets.

The Eclectic Paradigm

Incorporating the major factors that account for the motivation that leads to multinational production, the eclectic paradigm provides the necessary foundation. The eclectic paradigm was initially proposed Dunning in 1977 and gradually evolved into contemporary theory. The eclectic paradigm identifies those factors relevant to the decision to become a multinational firm and from these constructs a conceptual framework that explains multinational production. According to the paradigm, the performance of multinational enterprises is determined by three sets of factors: ownership advantage, location advantage and internalisation advantage.

Incorporating the theory proposed by Hymer discussed above, the eclectic paradigm

incorporates ownership advantage as the first set of factors, although here it is directly linked to the ability of the firm to deal with the competition in foreign markets and as such, is called firm-specific advantage in this context. In the initial paper, Dunning describes ownership advantage from three aspects of corporate capability. The first stems from the exclusive privileges that allow the company to possess or access specific income generating assets, such as the patent or unique technology that enable the firm to innovate new products or to differentiate existing products from the mainstream. Secondly, Dunning argues that the firm-specific advantage can be determined by the methods and extent in which the current firm's operations can support its foreign expansion. For example, depending on the existing advantage gained from economies of scale in current operation, the newly acquired foreign plant will have superior productive resources and materials compared with the local competition. The final ownership advantage derives from the firm's ability to create or add value for the benefit of its multinational operations as part of a portfolio of business in various locations. This advantage can be a function of the level of knowledge and information acquired to conduct corporate management or marketing activities. Moreover, the ability of the firm to devolve these intangibles to foreign subsidiaries, and the extent to which these intangibles can be used to compete in particular foreign markets, will further determine ownership advantage. Generally, the ownership advantage in the eclectic paradigm can be referred to as the specific characteristics of the firm that enhance it to retain a competitive advantage and survive in foreign market.

The second group in the eclectic paradigm that shapes the outcome of multinational enterprises are the advantages derived from location-specific characteristics. These represent the absolute and relative benefits of different locations for multinational production. In fact, the characteristics of specific locations, such as subsides from local government, good local infrastructure, a robust institutional environment or lack of ethnic conflict, will clearly appeal to foreign companies to locate in the area. Dunning and Dilyard (1999) states that the location

specific advantage of a particular location rests on the ability of national or sub-national markets, and of governments, to provide a unique set of long-term assets essential for investing firms (p 12). To construct robust models of locational advantage that truly explain why firms choose specific production destinations and to what extent locational characteristic impact on this choice. While the eclectic paradigm separates location advantage from ownership advantage, Dunning agrees that the location advantage and ownership advantage are by necessity interdependent. Dunning explicitly acknowledges that at the same time as the company exercise their location advantage, ownership advantage should also be considered. On the other hand, the exercise of location advantage is also influenced by imperfections in local market that arise from positive transactions cost barriers to free trade.

In the eclectic paradigm, the final factor determining multinational production is the internalisation advantage. Based on the concept of internalisation theory, multinational enterprises can benefit by coordination within the organisational structure and thus eliminate major transactions across national borders. To consolidate the benefits of internalisation advantage, the multinational can establish an internal hierarchy within the subsidiary structure of the total worldwide organisation. Different responsibilities can be assigned as part of a strategy aiming to achieve location-specific advantage in each area. However, in reality, the extent to which a company can realize any internalisation advantage varies considerably. For example, the ability of a multinational company to harmonise the production in different geographical areas can significantly determine the success of international operations. Companies at the start of their international operations will take some time to acquire the necessary experience and internal hierarchies such as inter-firm alliances or network take some time to establish. As they become more efficient, the company will be able to maximise the benefits from the internalisation of production. Higher level of integration results in synergistic advantage impacting both vertical and horizontal processes, with direct benefits to the company.

Eclectic Paradigm – Contextual Factors

The previous section has outlined the structure of the eclectic paradigm and the three sets of advantages accessible in multinational production. However, before this framework can be applied in an empirical analysis, some contextual factors must be considered. The value of this model for any particular firm depends largely upon four contextual variables.

The first set of variables address the question of why the company is involved in multinational operations in the first place. The basis motivations for companies to undertake multinational production vary considerably, and will have a bearing on the distribution of advantages between ownership, location and internalisation. Dunning (1993) distinguished four different incentives that can motivate company, namely, resource seeking, market seeking, efficiency seeking and strategic asset seeking, all of which are based on the common aim of maximising the value of the firm.

The second set reflects the influence of the firm's country of origin. Given differences in resource endowments across the world, this is a major determinant of the extent to which firms can benefit through ownership, location and internalisation advantage. These inherent differences mean that countries have actively or passively developed in ways that have enabled them to prosper in as part of a global environment, with some encouraging outward investment or as the recipient of inward investment.

The third set of factor is associated with industry level effects that particularly apply to firm internationalisation. It is clear that certain industries or types of businesses have a greater tendency to have multinational operations. For these activities, foreign expansion appears especially appropriate, while advantages in terms of ownership, location and internalisation are not so obvious in others. However, different industry sectors can also require different conditions, such as subsidies, intellective property protection, abundant and cheap labour, highly skilled labour, infrastructure and the benefits arising from the economics of

agglomeration. Consequently, these contextual factors are highly industry specific.

The final set of contextual variable deals with innate firm differences. These include factors such as size, history, market, product range, the degree of external and internal integration in production processes, the management team and corporate culture and identify. These can result in huge variations in the levels of success achieved by multinational production.

The eclectic paradigm has provided a useful framework for research. Particularly with empirical studies, the inherent differences are highly relevant as a wide range of production processes are moved into the international arena. Many of the factors discussed are interrelated and the direction of causality is frequently ambiguous. This literature has provided a guide to modelling multinational production decisions at the firm level but takes account of exogenous factors and industry specific characteristics. Criticism of the initial arguments of the eclectic paradigm has focussed on its generality, rather than explicitly take a single testable hypothesis to task. Although the explanatory power of the eclectic paradigm on specific area of multinational production may be limited by its generality, this can be strengthened by firm level factors. In summary, the merits of the eclectic paradigm as a research tool are enhanced by the inherent flexibly to resolve micro level controls.

The Uppsala Model of Internationalisation

Both Dunning (1980, 1988) and Hymer (1960) adopt a relatively static perspective to explain foreign investment as a series of choices dictated by specific efficiency considerations and relative transaction costs and benefits. By contrast, in the spirit of Vernon (1966), another tradition of international business views internationalisation as a sequential process of increasing involvement within and across foreign markets. Within this tradition, the Uppsala model is one of the most cited and contested theories in the literatures (Chandy and Williams, 1994).

The Uppsala model is developed by a series of papers by Johanson and his colleges at Uppsala University, Sweden. These argue that the expansion of firms into foreign markets is undertaken on the basis of incremental steps (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977; 1990). According to the model, one of the primary obstacles to international operations is the lack of knowledge about foreign markets. However, this market knowledge is accessible to foreign investors. The model argues that acquiring knowledge is necessary for a multinational enterprise to be active in the new market, although this requires the intangible commitments of the firm to increase its connection with the market (Hadjikhani, 1997). Further, to tackle market uncertainty in the unfamiliar environment, the model argues that a learning process is required for the investing firm, and based on a learning by doing proposition, decisions and their implementation concerning the foreign investments are made incrementally. Johanson and Vahlne (1977) argues that as long as the perceived risk remains higher than the maximum tolerable risk, the company will rather postpone investing in new markets. Finally, the model advocates the concept that the experience itself can never be transferred (Penrose, 1959). Therefore, the knowledge accumulated by the experiences of problem solving that are intrinsic to a foreign market will be learned and maintained primarily by those who are working in the market.

Basing on the four core concepts of market knowledge, market commitment, commitment decisions and current activities, the Uppsala model addressed how organisations learn and how the learning behavior causes incremental steps in the internationalisation process (Clark and Pugh, 2001). Explicitly, the model predicts two basic rules for the pattern of firm internationalisation. First, the foreign investment is begun and continued in just one or a few neighbouring countries, rather than in several countries simultaneously. Second, the operation in a specific country is carried out on a step-by-step pattern to establish a chain of contacts - for example, the move from pure exporting to appointing an agent to setup a sale subsidiary overseas and, finally, establishing a production facility. At the same time, the operation is

accompanied by a process of learning from people working in the marketplace.

The process of incremental knowledge accumulation in the Uppsala internationalisation model provides an alternative view to the tacit tradition in the international business literature that discusses how the firm reacts to the location attractiveness of a host-country, and gradually shapes the spatial distribution of corporate foreign investments. Specifically, in order to limit market uncertainty and to facilitate knowledge accumulation, the physical distance is considered critical in the model as the factor that determines which market the international enterprise will enter. Moreover, according to the model, knowledge accumulation depends on current activities. With the knowledge gained from these activities, the company acquires valuable insights to continue operating in this location. At the same time, the increasing investment in the location will deepen its commitment to other actors in the market and reduce the alternative uses of the committed resources. All of these cause the firm to stick to specific markets with familiar environments rather than explore new business alternatives (Forsgren, 2002).

In terms of organisational learning, the Uppsala model primarily recognises single a approach of learning through experience. However, other studies have revealed multiple dimensions on this. An organisation can gain access to knowledge from other firms, without having to go through exactly the same experiences (Eriksson et al, 1997; 1998; Hansen, 1999; Kraatz, 1998). Specifically, mimetic behaviour (Huber, 1991), by acquiring organisations or hiring people with the necessary knowledge (Barkema and Vermeulen, 1998; Huber, 1991) and conducting a focused search for new information (Huber, 1991), all have potential for organisational learning. Thus, the unitary view of the Uppsala model on the experiential learning may not hold for some firms that have diffuse international operations and undertaken more disperse strategies for foreign investment. Forsgren (2002) states that "*the fact that firms sometimes "follow the herd" when they invest abroad, or learn through the imitation of other organisation – network partners or organisations with high legitimacy – should also be*

included in a model of internationalisation behavior" (p. 274).

The Strategic Decision Model

Over the past few decades, researchers have attempted to model strategic decision-making processes, for example, Mintzberg et al (1976), Hickson et al (1986) and Hart (1992), although empirical testing of these models remains incomplete (Schwenk, 1995). Perhaps not surprisingly, a single model to explain the decision process in practice is inappropriate, and much of this research has focussed how parties involved in strategy formation interact amongst themselves. One popular area of research considers the cognitive process of managers, such as Huff (1990), or of organisation, such as Prahalad & Bettis (1986) and Lyles & Schwenk (1992) and their response to challenges arising from changing environments.

These studies do not only support managerial influence on strategy formation, but more importantly, they argue that, as with individuals, organisations adjust to competition from external environments, and their strategic responses reflect this. Prahalad and Bettis (1986) suggest that the strategic decision process is guided by the dominant managers' judgement and this reflects the shared view of the firm. Extending this from the discussion of the managers' judgement, Lyles and Schwenk (1992) suggest there are processes in which ideas from various individuals within the firm are combined to develop policy at the organisational level. Moreover, when environmental change invalidates existing management responses to challenges, members of the management team articulate their views on how to retain or recover high levels of competitiveness. These are then coalesced by the dominant coalition of managers into a revision of organisational strategies that fit the new situation. The ability of firms to do this is large dependent on the individual contributions but also on the effectiveness of the dominant coalition. Thus, the study of how dominant coalitions function is essential in the understanding of strategic decision-making.

bankrupt firms are associated with smaller board size, but their test further pointed out firms with a smaller board at the time of bankruptcy are more likely to survive in the post-bankruptcy period. Other studies consider situations were the chief executive office is also the chairman, and the propensity for this to occur in failing firms. Daily and Dalton (1994a, 1994b) confirmed that compared with surviving companies, bankrupt firms had a greater incidence of this dual structure.

In contrast to these cross-section studies on specific corporate situations, others research has adopted a more dynamic prospective to examine the causes and consequences of turnover of senior management and strategic change. For example, a number of case studies of recovered or rescued firms have documented how new executives can bring different skills and new perspectives to problems of declining firms, for example, Nystrom and Starbuck (1984) and Slatter (1984). Michel and Hambrick (1992) report that the characteristics of senior managers can achieve significant impacts on developing diversification strategies. Wiersema and Bantel (1992) showed that using more flexible strategies within an organisation is positively related to characteristics such as being relatively younger, being more experienced and having a level of educational. On the other hand, environmental factors within firms influence the choice of the upper echelon team (Keck and Tushman, 1993). Thus, changes in organisational environments may cause a shift in the characteristics of the team that are necessary to respond to different competitive situations. Finally, Wiersema and Bantel (1993) showed that turnover of senior team members was lowest when the company faced a munificent, stable, and simple environment.

Conflicts in Upper Echelon Teams

Unlike the work on the heterogeneity of senior manager characteristics, other studies emphasize the operational patterns of upper echelon teams. To capture the effect of interactions among team members in their decision-making, this work focuses on the conflicts arising from

the decision process. The traditional view has been that conflict among senior team members obstructs decision-making, for example, Hickson et al (1986). More recently, however, researchers have found that conflict can improve the quality of decisions and enhance understanding of the environment (see Schweiger et al, 1986a; 1986b; Schwenk, 1990a; 1990b). Amason and Schweiger (1994) point out that conflict can appear in different forms. If the conflict is cognitive, based on task-oriented principles, or arising from differences in judgment or perspective, this could facilitate the exchange of information among the team and be beneficial overall. But the conflict can be affective, when it is based on personal incompatibilities or disputes, it can produce suspicion, distrust, and hostility among team members, which is detrimental for strategy decision. Ensley et al. (2002) provide evidence that cohesion within the senior team is negatively related to affective conflict and positively related to cognitive conflict, suggesting the dual-effects of conflict on decision quality.

Several researchers have warned that when teams try to obviate affective conflict, it may simultaneously constrain occurrences of cognitive conflict and thus reduce decision quality (see: Schweiger et al,1986a; 1986b; Schwenk, 1990a; 1990b; Pinkley, 1990; Pelled, 1996; Pelled et al, 1999). For example, some studies suggest higher heterogeneity in senior managers is a way to stimulate information exchange and enhance decision quality (see: Hambrick and Mason, 1984; Nemeth, 1986; Bantel and Jackson, 1989; Eisenhardt and Schoonhoven, 1990; Hambrick et al, 1996). However, heterogeneous teams require greater coordination and monitoring, as noted by Cho et al (1994) and Priem (1990). If this does not occur, harmful conflict may obstruct communication and undermine the team's ability to act collectively (Priem, 1990; Eisenhardt and Schoonhoven, 1990). Pelled et al. (1999) explains that the dilemma for conflict is based on the fact that no one truly takes criticism happily or likes to be contradicted and when disputes take place, senior team members may feel that others do not respect their judgement.

Fortunately, recent theoretical and empirical research has showed that cognitive and

affective conflicts do not necessarily occur simultaneously (Jehn, 1994; Jehn, 1995; Amason et al., 1995; Amason, 1996). These studies argue that senior managers prefer to retain conflict where it is task-focused. When the conflict is oriented to individuals, this is detrimental and the commitment of that manager will decline and be less able to make high quality decisions. Thus, where there is a stimulus to use cognitive conflict in strategy decisions, team members may choose to remove any affective factors from the interaction process. Amason and Sapienza (1997) provided evidence that with strategies to stimulate team efficiency, the top management are more likely to engage in cognitive conflict but limit affective conflict. Thus, not only will high quality strategic thought be ensured but the commitment, coordination and trust among team members would be established in the team, all of which are essential for good planning and implementation (Tjosvold et al., 1992; Jehn, 1994; Mohr and Spekman, 1994).

Although senior management may be averse to personal conflicts intrinsically, in certain circumstance, it may be important to retain dominance in the decision process and comply with the interests of specific parties. Consequently, interaction among managers can cross the line of pure conflict to a conflict of interest where the politics of the firm becomes involved in the process of decision making. Eisenhardt and Bourgeois (1988) differentiated politics from conflict as politics being those covert actions by which executives enhance their power to influence a decision. Moreover, from a study of eight microcomputer firms, they found that politics tended to emerge when power was centralised, whereas the occurrence of politics was negatively related to organisational performance. As the politics are based in contests of self-interest, contests amongst senior managers, when it appears to be harmful to the quality of decision-making, implies a principal-agent problem has arisen. In a theoretical paper, Eisenhardt (1989) suggested that an agency prospective might provide a feasible framework for the study of conflict and politics in strategic decision-making.

From Upper Echelon Theory to Corporate Governance

Fundamentally, corporate governance deals with the agency problem to assure the corporate finance provider get a return on their investment (Shleifer and Vishny, 1997). Compared with upper echelon theory, corporate governance is more about emphasising the legal obligation of the management team in corporate management. Facing the fact that corporate management is unavoidably separated from ownership and the company management team hold substantial power in corporate issues, it is necessary to set a robust framework to monitor the moral hazard that may be an outcome of managerial discretion. On the other hand, with established frameworks, the self-interest factors can be reduced, since from the agency prospective, the quality of strategic decisions and the value of the firm would be enhanced if the company is able to construct efficient governance mechanisms.

Numerous empirical studies have been reviewed in Chapter 2 that prove that self-interest is part of strategy decisions and a robust governance system is necessary to constrain the problem *post ante.* Through monitoring the potential problems of management, governance mechanisms can discipline the activities of the upper echelon team and stimulate the development of superior strategies. For example, the findings of Bhagat et al. (1990), Lang and Stulz (1994), and Comment and Jarrell (1995) link poor quality of corporate governance with the adoption of value-reducing strategy relating to diversification, which extends the operations of the firm to unfamiliar areas. Moreover, companies with poorer governance efficiency are found to be more likely to undertake negative return take-overs (Lewellen et al, 1985), resulting in little or no benefits to shareholders (DeAngelo and Rice, 1983; Ryngaert, 1988; Malatesta and Walkling, 1988).

Models of Internal Governance in Multinational Enterprises

International theory has addressed the motives of multinational enterprises to internalise cross-border transactions within the firm. Strategic decision theory has also enhanced levels of

understanding that explain how different patterns of corporate internationalisation are achieved. However, the precise form of the internal governance architecture in a multinational enterprise has still to be explained and will be addressed next.

Governance Costs of Internal Transactions .

According to the transaction cost perspective, the primary reason for multinational enterprises is to internalise external transactions into the production hierarchy in order to minimise or avoid the costs arising from market transactions. However, to do this incurs considerable pecuniary and non-pecuniary costs to managers. In particular, multinational production involves several intermediate products made by subsidiaries worldwide. This results in high costs of internal governance that follow from the co-ordination of effort across the firm. Teece (1983) argues that governance costs are a crucial factor in determining whether the company will internalise specific production activity within the firm and explains the scope of the effect on corporate operations. In the study, governance costs are a function of the complexity of knowledge and asset specificity relating to internalising market transactions. In addition, the risk of expropriation during the range of operations is also a crucial factor. The greater the risk, the more international governance costs will be achieved. If there is high governance costs in internalising direct transactions, foreign expansion by FDI will be avoided and other methods, such as licensing or purchasing may be preferable.

Buckley and Carter (1996, 1998) use the problem of organisational design to identify the governance costs of internal transactions. These include the problems of communicating information, the co-ordination of complementarily among internal productions and the ability to limit opportunistic behaviour in corporate development. They argue that in optimal organisational design all participants have access to the best decision-relevant knowledge, all complementary actions are chosen jointly and all corporate members share a common objective function. Then, internal transaction costs will be eliminated. In contrast, deviating from this

optimum incurs losses and operational costs associated with internal transactions. Specifically with respect to information sharing, the internal transactions of the company suffer from poor decision-making plus the addition costs of finding and filtering the correct information. Departure from the optimal level of co-ordination will result in the lack of activity matching and the loss of synergy that fully complementary production allows. Finally, departure from the optimal conditions for motivation will cause corporate losses from members pursing individual objectives and behaviour.

Governance Costs in Multinational Firms

It would be reasonable to predict that internal transaction costs will be greater where firms are operating in a number of countries rather than only one. In particular, the spatial separation of internal transactions related to multinational operations will naturally increase costs, with respect to information sharing, co-ordination and complementarity in production and shared objective functions. Although the latest technology effectively shortens the spatial distance between overseas subsidiaries and facilitates internal cross-border transactions as single country operations, the investment to acquire the technology will cause an additional transaction cost. Thus, the multinational enterprise will require higher expenditure on internal governance to overcome the additional externalities of internal transactions that arise from multinational operations.

Apart from the difficulty of spatial separation, factors such as language differences can cause an additional barrier to internalising multinational transactions into the firm, fundamentally increasing the transaction costs of communication and co-ordination. Despite the prevalence of English as the global business language, easing communication costs of the multinational enterprise and possibly converging with local costs, more expenditure may be necessary for recruitment, education and training. But, perhaps the hardest problem is to confront motivation in individuals that do not share the same objectives. Cultural differences

may make motivation or discipline difficult to manage in organisations comprised of employees with a range of alliances and loyalties and for whom a single alignment with corporate culture is not possible. Thus, the problems relating to the greater geographical and cultural distances encountered within multinational operations are potentially the highest source of governance costs.

The question of cultural differences has been examined by Hofstede (1980). This research has shown that even in multinational enterprises, which operate within a framework of a clear and strong company culture, the managerial differences among national subsidiaries can still be overwhelming. The implications of this are the additional governance costs necessary to deal with the principal-agent problems that may exist between corporate headquarters and overseas subsidiaries and the efforts required to reconcile conflicting interests. In particular, through the process of multinational expansion, firms encounter various societal and institutional structures within the national environments of other countries, many of which are greatly different from those at home. In order to offset the costs of this lack of familiarity of local markets and institutions, the multinational enterprise may choose to manage the subsidiary locally. However, the effect of subsidiary management has the potential to separate even further local management from the headquarters, exacerbating the intra-firm transactions costs.

Governance in Multinational Firms

This divergence between wholly domestic operations and those of multinational enterprises, and the additional costs involved, is not new. Three centuries ago, Adam Smith explicitly advocated the concept that greater quality of corporate governance should be expected in companies involved in international trade. He wrote:

...It is upon this account that joint stock companies for foreign trade have seldom been able to maintain the competition against private adventures. They have, accordingly, very seldom succeeded without an exclusive privilege, and frequently have not succeeded with one. With an exclusive privilege they have

commonly mismanaged the trade. With an exclusive privilege they have both mismanaged and confined it. (Smith 1776/1976: ii. 264-5)

However, these relationships can be managed well, given experience and the willingness to adjust to new situations. Kogut (1983) compared the governance costs between experienced and inexperienced foreign investors and found that the corporate governance gap can be reduced as managers move along the learning curve and adapt to multinational operations. However, even this finding proves that the governance costs of multinational enterprise will be a declining function of time and geographical spread, with early costs unavoidable.

Buckley and Casson (1992) suggest several responses to the problem, including divisionalisation, matrix structures, and strategic business units and joint ventures. The first allows the multinational enterprise to make use of local information and assigns managers to different operating divisions that form part of the international network. In this way, the firm can create a series of national divisions that duplicate marketing and production from country to country, with sub-national divisions that operate within the same territory. By communication amongst divisions of both types, internal corporate information, resources and knowledge can be shared. The second possible solution is the matrix structure, which provides a series of connecting channels for passing information and increasing co-ordination. Strategic business units refer to a full matrix structure, not limited to existing information channels but involving intra-firm linkages among particular divisions that eventually form a team responsible for achieving specified corporate targets. Depending on the organisational structure, the internal transactions of the multinational enterprise should be more efficient in providing information and co-ordination once this is established. Finally, the network of joint ventures and alliances mainly refers to the external linkages of multinational enterprise with other companies, both multinational and local. Through the joint venture or alliances network, collaboration amongst companies will be possible, and companies can enlarge the scope of their internal transactions and compensate for the initial governance-related expenditure.

Although internal governance mechanisms do exist in the structure of multinational firms, these mechanisms can be cumbersome and represent a passive response to corporate governance. In terms of divisionalisation and matrix structures, they can be bureaucratic and hierarchical in character, which would complicate the transaction process within firms. Moreover, the strategic business units and joint ventures network are contingent upon the co-operation of partners that may be engaged in competing opportunist behaviour that caused the problem in the first place.

Corporate Governance Effect on Internationalisation Strategy

In theory, internal governance cost is an essential issue for a multinational enterprise, however, empirical studies to test in what extent this factor can impact on internationalisation decision, even though the corporate governance is revealed to be influential in certain strategy outcomes are rare. An early paper to do so is Filatotchev et al. (1999; 2001). Using data on privatised firms in Russia, Ukraine and Belarus, this research examined the roles of managerial ownership and managerial board representation on the process of strategic decisions about promoting export intensity. The study began by testing the effects of several possible strategies that would impact on exporting activity and then discussed whether the governance factors of the firm influenced the adoption of these strategies. Their results revealed strong evidence of corporate governance effects on strategic choices. In particular, both managerial ownership and managerial board representation had a negative impact on the adoption of export-facilitating strategies, although were positively associated with export-blocking strategies. As exporting activity would increase uncertainty, risk-averse managers opt for the less risky strategy rather than become involved in high levels of international commitments. Thus, strategic intentions to export were significantly influenced by corporate governance factors.

On the other hand, Carpenter (2002) discusses international strategies in a review of various issues related to the corporate governance effect on performance. In the spirit of

Prahalad (1990), the paper claims that internationalisation is a process that exacerbates the complexity of the total range of management tasks and the extent of this is a good proxy for environmental complexity. The extent of heterogeneity amongst senior managers, measured by education, functional background and tenure was found to be positively related to performance at low levels of internationalization, but had a negative effect at high levels of environmental complexity. Contrasting this finding to the conflict perspectives of upper echelon theory, it was found that managerial complexity would damage team efficiency by increasing affective conflict and decreasing cognitive conflict. While this work does not directly discuss the effect of corporate governance on strategic decisions, the findings do support corporate strategy as a critical contextual variable that moderates the relationship between governance mechanisms and management outcomes. Moreover, by adding the international factor into the process of corporate governance, the links between these variables is confirmed. Despise the ambiguous causality between corporate governance and internationalisation, this paper is interesting and will lead to further research to verify these linkages.

To further test the corporate governance effect on firm internationalisation, two further questions, neglected so far, are proposed by this thesis to test corporate governance effects on investing decision and location decision of FDI. The relevant literatures on the topics are reviewed next.

Corporate Governance and the FDI Decision

Given the increasing levels of integration in the world economy, internationalisation has become the mantra for corporate growth. In the past, international economists were more interested in the structure of trade relations than in patterns of foreign investment. However, flows of foreign direct investments during the last few decades have accelerated spectacularly, far outstripping the growth in world trade. The World Bank data (World Development Indicators, 1999) reports that worldwide FDI flows have grown from US$ 46 billion in 1980 to

US$ 644 billion in 1998. At the same time, statistics from the WTO (Annual Report, 1998) indicate that worldwide flows of FDI increased by over 1000% between 1984 and 1998, while world trade grew by only 91%. The remarkable increase of FDI flows confirms that this has become an extremely popular vehicle by which firms achieve their strategic objectives. Buckley (1996) argues that FDI represents a major strategic weapon for enterprises in their struggles for the world's appropriable surplus.

Compared with trade, FDI implies that the investor is able to exert a considerable degree of influence on the management of their overseas enterprises, which naturally gives rise to a greater level of risk and complexity for the firm. This makes FDI a quite different form of investment from a simple portfolio arrangement of organizational assets and knowledge (see Aliber, 1971, Kogut, 1983). Many studies consider FDI to be a strategy that extends corporate advantage in domestic markets to international ones (Caves, 1971; Dunning, 1980; Teece, 1981). Moreover, the bandwagon effect has been used to describe FDI motivated by companies' rush to invest abroad as a strategic response to oligopsonistic rivalry in home markets, Knickerbocker (1973). In contrast to outward FDI motives, some studies have argued that firms choosing multinational production rather than trade, do so because of transactional-cost-saving incentives and intend to internalise the necessary cross-border transactions within a single organization (Buckley and Casson, 1976; Hennart, 1982; Buckley, 1987). At the same time, the Upsaala model proposed by Johanson and Vahlne (1977) focuses on the diverse FDI opportunities available to a firm and suggests incrementalism in the process of foreign investment. An appropriate context for the discussion of this phenomenon is Dunnings eclectic paradigm (Dunning, 1980, 1995) discussed earlier. The paradigm is composed of three measures of specific FDI advantage to provide a comprehensive framework embracing most perspectives and models to explain and predict FDI related decisions.

In the international business literature, many studies have identified cross-country differences in the general political environment that are important factors in the process of

corporate internationalisation (Altomonte, 2000; Bavan and Estrin, 2000; Morisset, 2000; Stevens, 2000; Tuman and Emmert, 1999). At the same time, La Porta et al. (1998, 1999, 2000a, 2000b) suggest that the national institutional framework will determine the quality of corporate governance in the country. In a survey of 49 countries (La Porta et al., 1997), those with an efficient legal system to prevent agency problems had a positive and significant association with healthy economic development and larger international capital markets, whether predominately credit or debt based. A highly developed capital market enables resident companies to acquire financial resources and also provides access for firms in specific industries to reach strategic assets and markets, consolidating the advantages of FDI at that location. Oxelheim et al. (2001) noted that for firms resident in countries with small, illiquid capital markets, financial resources are essential for their survivor, particularly when facing international competition. Thus, the existence of a well-function capital market is an important factor, correcting the inherent defect of their home country. In summary, it is expected that the country with better institutional infrastructure in corporate governance will reduce the political risk of a location and strengthen its functional value in global operation, in turn encouraging further FDI inflow.

Further research on the role of governance infrastructure in influencing global FDI flows is Globerman and Shapiro (2002), using data on 144 developed and developing countries from 1995 to 1997. This study assessed not only the extent to which governance infrastructure attributes attracted FDI inflows but also on whether this increased the internationalisation of domestic firms. They used the same three variables as La Porta et al. (1997, 1999, 2000a, 2000b) to measure the quality of governance infrastructure: the effectiveness of the legal system in protecting individual property rights, the credibility and honesty of public institutions and the degree that governmental policies favour free and open market. Results clearly indicated that governance infrastructure is an important determinant of both FDI inflows and outflows. Moreover, for most countries, both inflows and outflows respond positively to good

governance. Kishi (2003) too, provided empirical evidence in the context of the Asian financial crisis to support the view that efforts to upgrade financial infrastructure approximate to optimal corporate governance is critical for the enhancement of FDI inflows. According to the arguments of existing studies (for example, Claessens et al., 2000; Johnson et al., 2000; Mitton, 2002), the poor institutional environment of the South-east Asian countries accounted for the difficulty they had in responding to the crisis. A survey by Kishi on Japanese FDI projects in East Asian countries was used to compare the profitability of these firms before and after the financial crisis. Results show that the FDI cases located in Asian countries that actively engaged in financial reform after the crisis, such as South Korea and China, outperformed the rest.

Thus far, many studies have recognised the institutional framework of corporate governance as one of the locational advantages to motivate or attract FDI, however, in this review of the international business and corporate governance literature, it is rare for existing research to treat corporate governance as a firm-specific advantage that determines the decision to undertake FDI. While Globerman and Shapiro (2002) have confirmed the importance of governance institutions to FDI outflow, the form of the governance factors in firm level FDI decisions remains ambiguous. The links between corporate governance mechanisms and strategic decisions has been extensively discussed and it does appear that a significant relationship can be found between them (Berger and Ofek, 1995a; 1995b; Denis et al, 1997). Given this consensus, it is reasonable to expect that FDI decisions are influenced by corporate governance factors.

Spatial Distribution of FDI

In the internationalisation theories, locational factors have been widely treated as crucial elements (for example, Hymer, 1960; Dunning, 1977). In addition, an extensive empirical literature has developed that tests the effect of specific locational factors that may attract or

repel foreign investors. Among these, one of the most common arguments is that locational characteristics based on macroeconomic conditions are responsible for FDI spatial distribution outcome. Coughlin, Terze and Arromdee (1991) observed FDI in the US during the period 1981-1983 and found the three macroeconomic characteristics most influential in determining the location decisions were per capita income, wages, and the density of manufacturing activity. Similarly, Woodward (1992) studied the spatial distribution of Japanese manufacturing affiliates in the US during the 1980s and found that the locational decisions of Japanese investors tended to be influenced by market size and low unionisation rates. Also focusing on Japanese manufacturing firms in the US, Yeung and Strange (2003) found that educational standards of the workforce, the size of local markets, transportation infrastructure and average labor cost are highly significant in location decisions.

In addition to macroeconomic conditions, several researches argue in favour of the agglomeration effect, that is, previous investments in the area is also critical in the choice of location of FDI. Head et al. (1995) examined the location choice of 751 Japanese manufacturing plants worldwide and found a strong agglomeration effect, with companies with similar industrial backgrounds tending to cluster their FDIs in a common location. This is supported in further country studies, for example, using a sample of French companies between 1985-1995, Crozet et al. (2004) confirmed the positive effect of agglomeration. This is even stronger in situations where the country of origin and industrial sectors are common. Inward FDI to China is particularly characterised by an agglomeration effect. With a sample of 931 foreign ventures in China, Head and Ries (1996) found that even though government policy plays a significant role in attracting foreign investment into the country, the spatial distribution of FDI is influenced by existing patterns of industrial concentration. Cheng and Kwan (2000) support this view and point out that except for the attractiveness of macroeconomic conditions, existing FDI in China generates further investments.

However, government policy that establishes a favourable environment for foreign

investment can provide a significant incentive and does attract FDI to a specific location. Generally, this policy is in the form of tax benefits and improved infrastructure. In terms of tax benefits, Hines (1996) found that bilateral agreement between the US and elsewhere granting foreign tax credits was an important factor in encouraging inward FDI to the United Stated. Glass and Saggi (2000) support this with empirical evidence that with government policy directed at reducing taxation on multinational production, countries benefit from further FDI compared with competitive locations. Haufler and Wooton (1999) compared the tax burden in two countries with unequal market size and demonstrated that FDI is more likely to be located in the country with a large market, however, the link between corporation tax and consumption tax was a contributory factor in the decision model. On the other hand, Barrell and Pain (1999) found that except for the macroeconomic reasons, Japanese FDI in EU countries and in the US is significantly motivated by the inefficiency of local markets that arises because of trade protection measures. Buckley et al. (2003) explicitly argued that the establishment of NAFTA and the EU form a significant trading bloc increasing discrimination against outsider firms to compete in the integrated area. Meanwhile, the preferences of local production can be increased, thus enhancing the motivation of inward FDI from the outsider companies.

In a comprehensive study, Crozet et al. (2004) suggested that the determinants of FDI location choice can be classified into four. The first are two macroeconomic factors, market demand and factor costs. The third is the agglomeration effect, determined by the number of local and foreign firms, and finally, public policies designed to support FDI activity in the location. Applying these four determinants into Dunning's eclectic paradigm, FDI motivation can be explained. Factor costs are a resource seeking motive, local demand conditions are a market seeking motive, agglomerate effects explain the motive to seek strategic assets related to exploiting FDI investment and favourable policies are and efficiency seeking motive. This confirms that location choice is a meaningful element in the FDI decision, which can be represent and explain features of strategy designs related to FDI.

With respect to the critical decision to allocate corporate resources globally, the preferences of the upper echelon team, reflected by governance characteristics, can be responsible for the spatial distribution of corporate FDI. Moreover, the firm-specific advantage of corporate governance is likely to interact with the location-specific advantages of host countries and is a determining factor in the FDI location decision. This questions remains neglected in most empirical studies but can be essential in understanding the impact of governance mechanisms on internationalisation strategy. Meanwhile, the study can also have potential to model the simultaneous effects between the three FDI-specific advantages in terms of ownership, location and internalisation in Dunning's eclectic paradigm.

Conclusion

This chapter began with a review of the literature on international business and the operations of multinational enterprises. The history of internationalisation theory can be traced back to the late eighteenth century, although the early theories concentrate trading advantages and are no longer as powerful in the current global economy. Dunning's eclectic paradigm that encompasses internationalisation theory has provided a valuable analytical framework in which to study current international activity. Moreover, the perspectives of the transaction costs, resource-based and Uppsala internationalisation models are included and are directed towards the literature on strategic decision theory as a crucial factor in determining corporate outcomes. The chapter also includes the literature on the role of the top management team and the impact this has on the nature and effectiveness of corporate governance.

The latter part of this literature review links internationalisation with corporate governance. In particular, the existence of the multinational enterprise is linked to the motivation to internalise cross-country transactions into the established hierarchy of organisational structures. However, large amounts of governance costs can arise from this process of internalisation in the operations of internationalisation, in ways that not occur to

purely domestic enterprise. Therefore, more robust governance mechanisms are required for multinational enterprises to facilitate these internal transactions. Finally, the chapter reviews the existing literature that tests corporate governance effects on the strategic decisions relating to internationalisation and proposed potential research topics that remain neglected so far.

Chapter Five: Data and Methodology

Introduction

This thesis investigates the impact of corporate governance on performance and on the strategic decisions relating to the international business activities of listed companies in Taiwan. Of the three empirical chapters, the first is concerned with performance, the second with the FDI decision and the third with the location of that FDI. The models used in the empirical analysis include a number of control variables, as well as various measures of corporate governance. There is considerable overlap in the data used in these chapters, and consequently a general description of the data construction, any transformations that are undertaken, and the definitions of the control variables are prior dealt in this chapter. A full explanation of the data is essential, as this is an important part of the study and the resulting data is both rich and unique.

The econometric methods used vary in each case although some of the problems and solutions are also common to all three empirical chapters. Therefore, a general overview of the estimation and testing methods will be presented here, although more detail specifications will be given in each separate chapter.

Sample Selection

Process

The primary criterion for sample selection in this thesis was that the firms should be listed on the TSE. This excludes privately-owned firms that have less rigorous reporting requirements, and access to data for publicly-traded firms is also considerably easier than for those that are not accountable to the SFC. Financial firms were excluded because of their different reporting requirements, and the fact that they are accountable to the Ministry of Finance directly rather than the SFC, but also to ease comparisons with other studies of

corporate governance in the literature. A final criterion in selecting the sample was the availability of a panel dataset for the performance measures. If a company obtained a listing, or was de-listed, within the sample period, then it is excluded from the sample.

The period of the data used in the performance study is from 1995 to 2000, while additional data up to 2002 were added for the internationalisation studies. One important aspect of this research is the Asian Financial Crisis, which occurred in 1997-98 directly in the middle of this estimation period. While this may be a disadvantage in terms of a tidy econometric model, one positive result is the plethora of papers that have been published on the topic of corporate governance and international investment strategies, making this one of the important issues in the economic development of the area. Although the direct impact of the crisis on Taiwan was relatively low, it is important to consider the results of this study in that context.

At the beginning of 1995, there were 299 companies listed companies on the TSE, of which 25 were financial and a further 46 had incomplete records, leaving 228 companies in the sample. These represented a number of industrial sectors, as follows: textiles (54), construction (40), electrical (54), services (36), and the remaining 44 were unclassified.

Dimensionality and Sample Period

To maximise the information content of the data, a panel dataset was obtained for much of the secondary data. Panel data, and panel data estimation techniques, have a number of advantages, although limitations in the data meant that it was not possible to exploit the econometric advantages to any great extent. However, it was useful to be able to have the time series available, since any year in the period close to the crisis is not wholly representative and using the mean of the years covering the crisis did reduce any potential bias.

One reason why the whole study was not fully able to exploit panel data methods was

that the data to construct the ownership data on the controlling families was only available for a single date 31st March, 2000. This restricted all of the family-based variables including family ownership and control and some of the board characteristics. The numbers of employees were also only available for one year and hence the labour intensity ratio is for a single year. However, the data on institutional investor shareholdings are taken directly from the TSE, and are available for the full five years, as are all the financial accounting items.

To deal with the unbalanced structure of this data sample, which provides panel data for certain variables but only a single year of data for the rest, the mean was computed and adopted where panel data was available, and then combined with the single year data to construct the total dataset. Further, 1998 was chosen as the base to calculate the age of firms since the establishments. The business group dummy depends on the measure of corporate ownership and control and so matches the year these data were accessible.

Further data relates to the foreign investments undertaken by the firms in the sample. This data includes investment location, investment value, ownership in joint-venture investment and the number of FDI projects undertaken. As the year of establishment for each FDI case is crucial in the analysis and the information is not reported, the list of corporate investments for two successive years was compared, and the increments were defined as initiated in the second year. When this data was acquired, the corporate foreign investments were disclosed only from 1998 to 2001. Therefore, the FDI cases undertaken in 1999, 2000 and 2001 were identified

Sources of Data

The data were obtained from four main sources: the SFC, the Taiwan Economic Journal, the China Statistics Yearbook, and the 2000 World Development Indicators.

The Taiwan Security and Future Commission (SFC)

The majority of the firm level data was acquired from the SFC. Listed companies disclose their financial report and accounts, subject to a common accounting principle. The government agency actively involved is the market regulator and the data are officially monitored and acknowledged.

The general statutory mandate of the SFC is to protect investors' interests, and the Commission is responsible for the development, regulation and supervision of the capital market in Taiwan. All publicly-traded companies have a legal responsibility to submit reports to the SFC on a regular basis. Based on the reports, the SFC have constructed a database beginning in 1995, which consists of information about public trading companies, and make this available for public access through the internet. This provides a very comprehensive set of information, which is invaluable for undertaking research on the impact of ownership on performance. This data also includes details about international investment flows, the amounts invested, the numbers of projects undertaken, and the location of these projects.

While corporate ownership information was provided by the SFC database, this is limited to shareholdings by corporate insiders, including managers, directors and supervisors and significant shareholders with holdings greater than 10%. Information in cases where the equity is distributed in the market, particularly to institutional and individual investors, is excluded. Thus, other data sources were required.

Subsidiary Data Sources

To collect the market information to construct the ownership variables, it was necessary to access the internal library of the TSE and refer to the historical market records for data on the trading situation of the sample companies. In addition, price data was collected from

the Taiwan Economic Journal, which is an on-line database covering the information of security trades in Taiwan, Hong Kong and China. Finally, for the country information in the internalisation studies, macro economic indicators relating to the FDI destinations within the PRC were obtained from the "China Statistical Yearbook". The Yearbook is a government publication from the Statistics Bureau, which provides province level data for China. For other country destinations, the World Bank database, "2000 World Development Indicators", provides 551 economic indicators for 206 countries between 1960 and 1998.

The Construction of Corporate Governance Variables

A critical series of measures in this thesis are those relating to ownership, since they are central to the investigation of the impact of corporate governance on firm strategy and performance. These were constructed as follows.

Status of Controlling Shareholder

It was necessary to develop a measure of the degree of ownership held by one family, or by family associates, so as to define a "family-controlled firm". There is a precedent in the literature. Both La Porta et al (1999) and Claessens et al (2000) identify a family, or individual, that hold either 10% or 20% of the equity, is able to substantially control a publicly-traded company. This study follows the spirit of these papers, although a different cut-off point is used. As noted in the previous chapter, the Securities & Exchange Law requires members of the board of directors and the supervisors to hold a minimum amount of equity in the firm. The amount is a function of the size of the firm and Table 4.1 in previous chapter denotes this. Given this legal requirement, a family-control firm is defined as that the family holds the largest volume of shares, in excess of the minimum legal requirement. For example, the directors and supervisors of a company with a market

capitalisation below NT$ 300 million are required to hold 15% and 1.5% of equity, respectively. So, if the shareholding of the family is greater than 16.5%, the company is considered to be family-controlled. If the shareholding is less than 16.5%, the firm is considered to have a widely-dispersed ownership structure.

To identify family control, the largest shareholder and the associated family members were obtained from a detailed list of the significant shareholders. This list is available from the details provided to the SFC on insider ownership, and includes the CEO, individual directors and supervisors, and significant shareholders with shareholdings over 10%. When the insider is an organisation, the list further specifies the names of its representatives in the firm. This enables us to identify whether the representative is a family member, and thus whether the organisational ownership is part of the shareholding of the family. After the family members have been identified, their shareholdings are summed to provide a proportion of total family ownership, and consequently, whether they have overall control or not.

Where one organisation is found to have a shareholding more than that of any other person or group, the organisation is defined as the ultimate owner. If this is a state or local government or equivalent, the controlling status is defined as state-controlled firm, and likewise, if a foreign institution, the definition is a foreign-controlled firm. For the remainder, it was not possible to trace the ultimate owner and these are defined as widely-held firms.

With the methods described above, 154 of the 228 samples are recognised as family-controlled firms, 6 as state-controlled, 26 as foreign-controlled, and the remaining 42 are treated as widely-held companies. Three Dummy variables were used to represent the effects of alternative modes of control.

Extent of Family Shareholding

Although the effect of ownership concentration on corporate value has been extensively discussed in the literature, the measurements of ownership vary considerably. Some studies include the shareholdings of board members (Arthur 2001, Mak & Li 2001), others the CEO shareholding (Core et al. 1999, Zhou 2001), and others the shareholding of senior managers in total (Himmelberg et al. 1999, Hanson & Song 2000). Where the theory is based on the argument that large shareholders are essential to ensure good governance, such studies use the shareholding of significant shareholders to examine the incentive structures (Demsetz & Lehn 1985, Ang et al. 2000). Still others are interested in the role of outsiders, and thus consider the shareholdings by outside block-holders as a proxy for their participation on corporate governance (Faccio & Lasfer 2000).

In this study, we follow Claessens et al. (2000) in identifying the membership of controlling families. We use the last name of the insider shareholders, including the board members, directors and supervisors, the CEO, the board chairman, the honorary chairman, the vice chairman, the organisational shareholder representatives, and any stockholder with over 10% ownership, and then match these with the largest owner. As the five major Chinese family names are Lin, Li, Chen, Chang and Wang, which are very common in Taiwan, it is not used to consider that all individuals sharing each of these five last names are from the same family. A further criterion is added to identify family members from these named families, that is, a shared first name. In traditional Taiwanese families, a common first name implies kinship and also has the role of indicating the generation of each individual within the family. After identifying all the family members related to the largest shareholder, the shareholdings of all the individuals within the family were added together to calculate the ownership of the family in total.

Extent of Institutional Shareholding

Institutional investors tend to be more aware of the fluctuations of the market, and objective in their valuation of corporate performance. Therefore, they may be expected to play an important role in providing better discipline than insider shareholders.

Basically, the status of institutional investors in the data was divided into three groups: financial institutions (banks and investment trusts), government agencies and other firms. However, the operation of foreign financial institution in the TSE has been permitted since the early 1990s. Considering the different investment strategies between domestic and foreign financial institutions (see Chapter 1), their shareholdings may impact distinctively on corporate governance. Similarly, the bank and the investment trusts are involved in security trading but from different motivation, their shareholdings are not likely to impact equally on corporate governance. Therefore, the final dataset for this variable has six elements: firms, government agencies, domestic banking institutions, foreign banking institutions, domestic investment funds and foreign investment funds.

The Composition of the Board of Directors

Five variables represent the characteristics of the board of directors: the independence or otherwise of the board chairman, the dual leadership structure of firm, the number of directors and supervisors, the family control of the board, and the proportion of equity held by the board members. Some of these variables are categorical, whilst others are quantitative.

- A dummy variable is used to represent the independence of the board chairman. This value has a value of 1 if the position is held by a member of the largest shareholding, and 0 otherwise. This variable depends only on the identification of the family with the largest shareholding, regardless of whether the family controls the firm.

- A dummy variable is used to denote whether the positions of Chairman and CEO are held by the same individual. This value has a value of 1 if the two positions held by the same individual and 0 if this is a dual leadership structure.

- Board size is an important characteristic and affects the efficiency of the board and the ability of members to undertake their responsibilities. With the two-tier board structure that exists in Taiwan, the operations of the board may be a function of the numbers involved. Thus, this variable is a separate count of the number of directors and supervisors associated with the firm.

- Family control on the board is measured by the number of family members on the board of directors, and also acting as supervisors. The directors and supervisors are considered separately and then summed. This is extended to account for other entities on the board and/or as supervisors from the state or financial institutions. In some cases a firm may have several different legal representatives on the board, although in this study, they are aggregated to form a single number.

- Finally, shareholding is considered as a board characteristic. Board ownership is measured by the total shareholding of directors and supervisors, again first separately and then jointly.

Control Variables for Performance Study

A number of controls are used in the regression models to capture specific contextual effects and to account for differences that are exogenous to the firm. There are four industry dummies representing n-1 sectors: textiles, construction, electrical goods, and services. The textiles sector includes the manufactures of clothes, natural fibres, chemical fibres, and plastic material. The construction section includes companies engage in real estate construction, and also manufacturers of building materials including cement, glass, and steel.

The electrical goods section is very diverse, and incorporates manufacturers of machinery, electrical appliances & cable, computers and semiconductors. The service sector is also highly heterogeneous, encompassing transportation, tourism, and both wholesale and retail trade.

Other control variables are the measure of labour-intensity, the employee scale of the firm, the age of the company, whether the company is a part of a group of businesses, the gearing ratio, and profitability. The labour-intensity is issued capital divided by the number of employees. The rationale for the group dummy is to see whether the ultimate owner is also the ultimate owner of another public trading firm in the TSE. It is not unreasonable to suppose that profitability could impact the effectiveness of governance mechanisms, particularly in a declining industry, short termism may accelerate the fall in firm value but be followed rather than a longer-term recovery plan. Two financial measures, the gearing ratio and profit margin, allow for the effects of performance on corporate governance.

Descriptive Statistics of Corporate Governance Variables

Table 5.1 reports descriptive statistics for the corporate governance factors and the control variables. As shown in the Table, there is 68% of the firms in the sample is family-controlled, and these families hold 17.5% of the equity, on average. Financial institutions (foreign or domestic banks and investment funds) are not significant shareholders, accounting for only 5.33% of the total equity issued, while "normal corporations" have an average 18.63% shareholding.

Table 5.1 Descriptive Statistics of Variables and Data – Corporate Governance

Corporate Controllers	Data	Mean	Std Dev	Max	Min	Number	Ratio*
Family Controlled Firm	31/Mar/00	-	-	-	-	154	0.68
State Controlled Firm	31/Mar/00	-	-	-	-	6	0.03
Foreign Controlled Firm	31/Mar/00	-	-	-	-	26	0.11
Family Shareholding	31/Mar/00	17.59	13.3	72.75	0.42	-	-
Institutional Ownership							
Domestic Banks	Average 1995-99	1.63	2.12	19.08	0	-	-
Foreign Banks	Average 1995-99	0.27	1	9.41	0	-	-
Domestic Funds	Average 1995-99	1.84	1.9	8.28	0	-	-
Foreign Funds	Average 1995-99	1.59	2.9	31.38	0	-	-
Governmental Agency	Average 1995-99	1.02	3.73	38.98	0	-	-
Normal Corporation	Average 1995-99	18.63	11.68	56.13	0.42	-	-
Board Characteristics							
Independent Chairman	31/Mar/00	-	-	-	-	52	0.23
CEO=Chairman	31/Mar/00	-	-	-	-	41	0.18
Director Size	31/Mar/00	8.22	4.44	26	3	-	-
Supervisors Size	31/Mar/00	2.05	1.02	8	1	-	-
Family Control - Director	31/Mar/00	46.88	27.44	100	0	-	-
Family Control - Supervisor	31/Mar/00	42.02	40.83	100	0	-	-
Legal Person - Director	31/Mar/00	48.92	35.31	100	0	-	-
Legal Person - Supervisor	31/Mar/00	59.81	42.4	100	0	-	-
Board Shareholding	31/Mar/00	20.67	12.48	72.75	0.61	-	-
Control Variables							
Textiles	Base Year - 1998	-	-	-	-	54	0.24
Constructions	Base Year - 1998	-	-	-	-	40	0.18
Electrics	Base Year - 1998	-	-	-	-	54	0.24
Services	Base Year - 1998	-	-	-	-	36	0.16
Issued Capital (NT$)	Average 1995-99	544m	786m	78223m	35m	-	-
Employee Number	1998 Average	1330	1947	17860	29	-	-
Company Age	Base Year - 1998	31	10	55	11	-	-
Business Group	31/Mar/00	-	-	-	-	83	0.36
Gearing Ratio	Average 1995-99	0.76	0.48	3.68	0.13	-	-
Profit Margin	Average 1995-99	5.18	16.43	77.56	-169.9	-	-

Note: * the ratio is "number" of the variable divided by total sample size 228.

It is notable that 23% of the firms in the sample have an independent board chairman, and another 18% have a joint chairman and CEO. The members of the board of directors far outnumber the supervisors, with mean values of 8.22 and 2.05 respectively. Furthermore, the controlling families are influential in management positions, controlling 47% of board seats and 42% of supervisors. On average, the extent of family control on the board far surpasses the level of shareholding, which bodes ill for governance and may

give rise to serious agency problems. Perhaps surprisingly, the organisational shareholders (legal persons) are also influential, accounting for 49% of directors and 60% of supervisors. The managerial power of this group of shareholders is dominant, especially compared with the 25% of institutional shareholding in total (financial institutions, government agencies and other corporations). Finally, the average shareholding of the board members is almost 21%.

The industry dummy variables show a reasonably representative selection, with a range of 16% to 24% across the sample, and 18% not specified. The size of firm, both measured by market capitalisation and number of employees indicates a range of small and large firms, with an average age of 31 years, although none are established less than 11 years. Finally, 36% of the sample is part of specific business group in which the largest shareholders also effectively control other listed-firm in Taiwan.

The Construction of FDI Variables

Testing the corporate governance effect on FDI strategic outcomes and the locational distribution of FDI projects is another aspect of this thesis. To conduct the relative analyses in the following chapter, the FDI variables were constructed in the manner described below:

FDI Data Structure

In order to capture the causal links between the structure of firm ownership an FDI decision outcomes, data on international investment projects two years after the identification of the form of control. Data is available in two forms, the total value of overseas investment and the number of projects undertaken. In this study, the FDI panel data is cumulative, ending in December 2001, compared with the ownership data that was reported in March 2000.

The financial data and firm characteristics are as before, with the mean of the period 1995-99 used when suitable. This is justified by the fact that FDI decisions are made as part of a longer-term strategy, although the actual investment may not take place in the period the strategy was approved.

The FDI cases in this thesis do not refer to any project with 0 or negative book-value in 2001, and the measure of the value of corporate FDI is based on the initial investment of each specific case. In the 228 firms used here, 166 firms were recorded to have foreign investment in China and 122 companies engaged in FDI in other countries, with several in both groups. The total amounts invested in China was approximately US$ 3,364 million, with the largest single investment US$ 375 million and the smallest US$ 10,000. For the firms investing elsewhere, the total was US$ 10,719 million, ranging from US$ 836 million to US$ 11,200. Considering the number of projects undertaken, 444 were initiated in China from the 122 firms, whereas 559 were initiated in the rest of the world by the 166 firms. However, the original FDI dataset was reported in cumulative form and disclosed after 1998, the annual basis of FDI information can only be recognised since 1999. Any international investment prior to that is not date specific and was only available as a total value of investment and number of projects. Thus, for the analysis, cumulative measures are appropriate. For the available annual data of the 444 FDI projects in China, there were 39 in 2001, 48 in 2000, 62 in 1999 and the remaining 295 in 1998 and before. For the 559 in the rest of the world, 18 were in 2001, 19 in 2000, 69 in 1999 and the remaining 453 in 1998 and before.

FDI Decisions Variables

There are three measures representing corporate FDI decision outcomes. The first is a binary dummy variable, which is equal to 1 if there is FDI and 0 otherwise. The second

counts the number of FDI projects undertaken by the firm until 2001, and if the book-values of the projects were 0 or negative in the year, they are excluded from this measure. Finally, the third represents the extent of corporate commitment to foreign investment and measures the accumulative value of each company in 2001 divided by the average capitalisation of the firm from 1995 to 1999. The accumulative value of corporate foreign investment is based on the initial investments of all foreign investment projects, and again, the projects with 0 or negative book-values in 2001 are not included in the calculation. Then, this series was split into groups determined by the first quartile, the mean, the third quartile and the maximum. These boundaries were named group1, 2, 3 and 4. A further group of 0 was added for completeness and to account for those firms that did not undertake FDI in China or anywhere else.

FDI Location Variables

As a special history and politic relationship exists between Taiwan and China, the FDI location options of Taiwanese firms in China are separated from the others. Further, the exact locations of Taiwanese FDI are generalised into several conceptual options reflecting common geographic and economic characteristics of host provinces.

One particular feature in the location choice may be the provision of a tax shelter, and tax-haven countries can provide an advantage in countries other than China. The identification of tax-haven countries in this study follows the list of Eiteman et al. (1998, pp. 549). Next, Singapore and Hong Kong are frequently desired choices for Taiwanese FDI. While these two countries are in the tax-haven list of Eiteman et al (1998), they are also close to Taiwan in culture and geography and traditionally play an intermediary role to connect Western and Eastern businesses. Thus, Taiwanese FDI in these two places can carry a unique strategic meaning. Then, South-east Asian countries are economic in

production cost and also geographically and culturally approximate to Taiwan, so again are a suggested location target for Taiwanese FDI. Moreover, the US, Japan and the EU are advanced economies that provide markets and technology for Taiwanese companies. These countries are grouped into another variable, with the control being all other destinations. Thus, there are five locational categories for Taiwanese FDI including (1) tax-haven countries, (2) Singapore and Hong Kong, (3) Southeast Asia, (4) Advanced Industrial Countries and (5) the rest.

Other location variables are functioned as different motivations for FDI, simply within China. The provinces vary considerable, with some economically vibrant and others lagging behind in economic development (Chadee, 2002). Because a dummy variable for all provinces would create degrees of freedom problems, China is divided into subsets that reflect the degree of development. In the study, the location choices of Taiwanese FDI in China are generalised into six groups: (1) north coast, (2) middle coast, (3) Fujian province, (4) Guangdow province, (5) metropolitan cities and (6) the remaining inland areas. The north coast (Hebai and Shandong provinces) and middle coast (Jiangsu and Zhejiang provinces) rely on heavy and light industries respectively, which can attract Taiwanese FDI in different manner. In addition, the business culture relies on Guanxi in the middle coast provinces, so they are open to other cultures with similar values, such as Taiwan. This can create an advantage for FDI activity. The north coast and central coast are separated as two individual location options for Taiwanese FDI. Fujian province in Chinese south coast is where many Taiwan nationals are originated, and so there is a similar culture and identical dialect, making this a familiar environment for Taiwanese business. Alternatively, Guangdong province is also on the south coast and has a long history in attracting foreign investments, particular from neighbouring Hong Kong. With the influence of Hong Kong business, Taiwanese firm can suffer particular competition in this area, and so this region is in a group. Finally, the metropolitan areas of China (Beijing, Tianjin and Shanghai Cities)

have huge populations, relatively advanced infrastructure and a lot of multinational businesses facilities, which can provide and opportunity and also a challenge for Taiwanese firm. Thus, the three biggest cities of China are also delineated.

Control Variables for FDI Decisions

The control variables described above are in the FDI analysis too, although the justification for their inclusion needs discussion. Firstly, the industry dummies are simply sector identifiers although it will be seen that there are inherent differences in the attractiveness of FDI as an international strategy in some sectors compared to others. Secondly, the size of the firm, whether measured by number of employees or issued equity, is important as some investment opportunities are available to large firms that are simply not an option for smaller ones. Equally, the years of establishment may be a factor in the FDI decision, since the historical background of the company may include a good or bad experience of international diversification that will influence future strategy. Finally, the performance of the firm may encourage an active involvement overseas if the domestic position is good, as is noted by Vernon (1966), Caves (1971) and Teece (1981), and not otherwise. Thus, financial measures, such as gearing levels, profitability and Tobin's Q (market price to book value ratio), based on the domestic performance of investing firms can be used to control for the relative effects of FDI decisions.

Descriptive Statistics for FDI Decision Data

Table 5.2 reports the descriptive statistics with respect to the FDI decision data. Of the 122 firms investing in China, 28 are in the textiles sector, 16 in construction, 29 manufacture electrical goods and 17 are in the service sector and the remaining 32 undefined. The mean market capitalisation is close to NT$ 504 million, with a range of

NT$ 78 million to NT$ 60 million. The average number of employees is 1,456, which indicates a very diverse group, ranging from nearly 18,000 to 46, while the age profile and performance reflects the previous data.

Table 5.2 Descriptive Statistics of Variables and Data – FDI Decisions

FDI in China	Data	Mean	Std Dev	Max	Min	Number	Ratio
Companies Number	2001	-	-	-	-	122	0.54*
FDI Value in China (NT$)	2001	827m	1348124	11,263m	382,000	-	-
Ownership of FDI in China	2001	70.08%	26.33%	100%	3.60%	-	-
FDI Project Number in China	2001	3.52	3.78	26	1	444	-
Textiles	2001	-	-	-	-	28	0.23**
Constructions	2001	-	-	-	-	16	0.13**
Electrics	2001	-	-	-	-	29	0.24**
Services	2001	-	-	-	-	17	0.14**
Issued Capitel (NT$)	1995-99	504m	562m	78233m	60m	-	-
Employee Number	1998	1456	2055	17860	46	-	-
Company Age	1998	31.17	9.58	51	12	-	-
Gearing Ratio	1995-99	0.76	0.43	2.84	0.13	-	-
Profit Margin	1995-99	6.58	11.77	77.56	-22.42	-	-
Tobin's Q	1999-00	1.52	1.39	11.02	0.4	-	-
FDI in Overseas							
Companies Number	2001	-	-	-	-	166	0.73*
FDI Value in overseas (NT$)	2001	1937m	3517m	25,087m	334,000	-	-
Ownership of FDI in overseas	2001	91%	13.87%	100%	11%	-	-
FDI Project Number in overseas	2001	3	2.39	13	1	-	-
Textiles	2001	-	-	-	-	34	0.2**
Constructions	2001	-	-	-	-	25	0.15**
Electrics	2001	-	-	-	-	46	0.28**
Services	2001	-	-	-	-	25	0.15**
Issued Capital (NT$)	1995-99	624m	893m	78223m	412m	-	-
Employee Number	1998	1541.9	2089	17860	29	-	-
Company Age	1998	30.9	10.16	54	11	-	-
Gearing Ratio	1995-99	0.81	0.5	3.68	0.13	-	-
Profit Margin	1995-99	6.02	17.63	77.56	-169.9	-	-
Tobin's Q	1999-00	1.69	1.74	11.02	0.4	-	-

Note: * the ratio is divided by total sample number of this thesis 228; ** the ratio is divided by sample number involved in FDI in China - 122, and in overseas - 166.

Of the 166 firms that invest overseas in countries other than China, 34 were in textiles, 25 in construction, 46 manufacture electrical goods and 25 are in the service industries. The remaining 36 firms were undefined. The average market capitalisation was NT$ 624 million, ranging from NT$ 78,223 million to NT$ 412 million. Compared to the China FDI, there is clearly a higher threshold for Taiwanese firms. On the other hand, the

average number of employees of these firms is 1,542, with a similar maximum of 17,860 but a much small minimum of 29. The period of establishment for these firms was similar to that for the China FDI firms. Finally, there are some differences in performance profiles, with a lower mean but higher dispersion for firms operating in the rest of the world, and interestingly, the least profitably is reporting a substantial loss.

Control Variables for FDI Location Choice

The spatial distribution of FDI has been studied extensively in the field of international business and various factors have been suggested as possible determinants of location choice. Much of the literature investigating the motivation for FDI and the direction of international expansion has been discussed in Chapter 3. The data and variables selected here follow much of this literature, particularly that of Dunning (1993), and consequently, four aspects of FDI are represented in the data. These are: resource seeking, market seeking, efficiency seeking and strategic asset seeking measures.

To investigate FDI location choice in China, macroeconomic data is useful, particularly, "average wages", "per capita consumption", infrastructure such as "transport links" and "total FDI inflows into the area" are used to represent the attractiveness of specific locations. The data in the China Statistical Yearbook are reported at the province level, however, some aggregation was necessary to create regions of homogeneity to fit for the setting location options.

Slightly different variables were required for the non-China FDI location decision model. The four location specific factors are replaced by a set of national macroeconomic data for the target country including the "balance of importing and exporting resources", "GDP per capital", "tax levels on goods" and "transport services exports" (the services performed by residents of one economy for those of another). The data was obtained from the World Bank 2000 World Development Indicators. However, to match the

macroeconomic data at year end 1999 with the investment year, given the precise year is unknown prior to 1999, the sample are divided into two groups, investment prior to 1999 and that later.

In addition to the pull factor of locational attractiveness, further variables are included in both the China and rest of the world FDI models to account for the push effect caused by firm characteristics that encourage overseas investment. The size and age are included, but also the distribution of shareholding, since this may influence FDI decisions. Finally, annual FDI value from Taiwan to China is used as indicator of the political tension between the countries. This represents the something of the conflict between the pushing effect of Taiwan's FDI and the pulling effect from China.

Descriptive Statistics for FDI Location Choice Data

Table 5.3 reports the descriptive statistics used in the analysis of FDI location choices, which includes both the total value of the investment and the number of projects involved. Since choice of location is determined in part by the economic environment, in terms of labour and infrastructure for a resource based approach and disposable income in a market based approach, this data is an important input. From the Table, the mean wage in the regions where FDI projects are located in China is 8,712 RMB (approximately US$ 1,050) and the mean per capita in consumption in those provinces is 6508 RMB (approximate US$ 784). The mean annual value of FDI inflows from all international sources is US$ 4,907 million and the mean distance available for transport 67,144 km, both of which are an indication of the overall attractiveness or limitations of the region.

Of the firms investing in international projects in this sample, the average capitalisation for those choosing FDI China is NT$ 809 million (approximately US$ 30 million), with an average age of 32 years. Further, the average investment value for a

single FDI project in China is NT$ 352 million (approximately US$ 11.7 million) and on average, the project was conducted through a joint-venture where the Taiwanese firm holds 70% ownership on the project. Finally, between 1990 and 2002, the total annual value of FDI from Taiwan to China was US$ 1,942 million.

Table 5.3 Descriptive Statistics of Variables and Data – FDI Location Choices

FDI Cases in China	Data	Mean	Std Dev	Max	Min	Number	Ratio*
Total Case Number	Feb-99	-	-	-	-	444	-
Investing Year - 1998 and before	1999	-	-	-	-	295	0.66
Investing Year - 1999	2000	-	-	-	-	62	0.14
Investing Year - 2000	2001	-	-	-	-	48	0.11
Investing Year - 2001	2002	-	-	-	-	39	0.09
Average Wage (RMB)	Feb-90	8712	2045	16641	5276.5	-	-
Per capita Consumption (RMB)	Feb-90	6508	1349	8868	3358	-	-
Total Traffic Length** (km)	Feb-90	67144	45087	140601	4352	-	-
FDI Reception (US$)	Feb-90	4907m	3843m	12019m	45.2m	-	-
Capital Scale of Investor (NT$)	1995-99	809m	874m	78223m	60m	-	-
Age of Investing Firm	1998	32.2	9.06	51	12	-	-
Investing Value on the FDI (NT$)	Feb-99	352m	512m	5783m	1.7m	-	-
Ownership on the FDI Case	Feb-99	69.94%	31.61%	100%	1%	-	-
Taiwanese FDI in China (US$)	Feb-90	1942m	525m	2915m	1583m	-	-
FDI Cases in Overseas							
Total Case Number	Feb-99	-	-	-	-	559	-
Investing Year - 1998 and before	1999	-	-	-	-	453	0.81
Investing Year - 1999 and after	Feb-00	-	-	-	-	106	0.19
Resource Balance*** (US$)	1987-99	-910m	38680m	64500m	-110200m	-	-
GDP per capita (US$)	1987-99	15284	7172	29605	991	-	-
Tax on good and service	1987-99	14%	10.70%	59%	2%	-	-
Transport Service Export****	1987-99	18.40%	14.70%	84.80%	2%	-	-
Capital Scale of Investor (NT$)	1995-99	7708m	12784m	78223m	412m	-	-
Age of Investing Firm	1998	29.76	10.03	54	11	-	-
Investing Value on the FDI (NT$)	Feb-99	420m	999m	13750m	282000	-	-
Ownership on the FDI Case	Feb-99	87.70%	23%	100%	2%	-	-

Note: * the ratio is divided by FDI case number in China, 444 and in overseas 559; ** Total traffic length includes railway and highway; ***Resource balance equals exports of goods and services minus imports of goods and services; ****Transport service export covers all transport services (sea, air, land, internal waterway, space, and pipeline) performed by residents of one economy for those of another.

In terms of the 559 occurrences of FDI from Taiwan to the rest of the world, 81% were undertaken in or before 1998 and the remaining 19% in or after 1999. This was a very uncertain period, particularly as a result of the South-east Asian crisis, and the balance of trade figures are, on average, negative for the period (US$ -910 million). The deviation in the current account data is high, with a wide range between maximum and minimum values.

Since this data represents FDI countries, the mean GDP per capital is not very meaningful, however, the range of countries is and here the maximum figure of nearly US$ 30,000 and a minimum of less than UD$ 1000, shows the diversity of locations that are deemed attractive investment opportunities.

Two factors that may provide strong incentives to undertake FDI in a chosen location are taxes and the ease and cost of transport. Again, the mean values are not very interesting, 14% and 18%, respectively, but the range is large. Locations with the minimum of 2% in taxes cost provide a considerable advantage over others with more progressive tax regimes. On the other hand, the location with transport provision for foreigners, with maximum of 84.8%, creates a strong incentive for FDI activity. The characteristics of the firms include market capitalisation, with mean of NT$ 7,708 million (approximate US$ 257 million) and age close to 30 years. The average investment value of a single FDI project outside China is NT$ 420 million (US$ 14 million) and on average, this investment is conducted through joint-venture partners holding 87.7% of shares on a single investment. Compared to the data on FDI in China, firms in Taiwan appear to retain a higher proportion of shares when FDI is elsewhere. With the exception of the macroeconomic variables, there is a common theme with respect to the characteristics of firms investing, whatever the location.

Research Methodology and Econometric Modelling

This section provides an overview of the methodology used and justifies the choice of technique. General issues are discussed and the models described, although the specifications used are presented in each of the empirical chapters that follow. The study aims to investigate the impact of models corporate governance on performance and on the strategic decisions make within the firm with respect to international business expansion.

The sample is taken from listed companies on the national stock exchange and as such, they are subject to disclosure requirements. Thus, information on accounting statements, capital structure, domestic and international business activities, ownership and the composition of the board of directors and supervisory members is publicly available. Because of the availability of data, and the focus on explaining performance and decision outcomes, modelling firm behaviour is approached using quantitative techniques.

Although regression analysis appeared to be the method of choice, it was important to consider other approaches. Survey methods were not judged to be appropriate as the research aims to explain ex post observations from a set of ex ante organisational structures and strategic decisions. Company level case studies are useful in some instances where it is necessary to understand the decision process, but when not in a study interested in final outcomes rather the path taken to achieve those outcomes. Furthermore, it was necessary to have as large a sample as possible in order to make inferences about the business sector in general, thus leading to the decision that statistical methods were the most suitable.

For this type of analysis, panel data economics is very appealing and the advantages of such methods are well known and discussed in detail in Baltagi (1995). Pooling cross section and time series lets both variances add explanatory power to the regressions, as well as ensuring ample degrees of freedom. The most valuable aspects are that panels give more informative data, more variability, less collinearity amongst the variables, more degrees of freedom and more efficiency in the estimates. It is also useful to be able to separate the cross section and time series effects.

However, when the population from which the sample is taken is a single country, with a common economic and cultural environment such as in this study, most of the variance is in the cross section. Not accounting for firm-specific differences in economic or behavioural assumptions, such as firms operating under different management systems or more or less restrictive regulations, can cause serious mis-specification. Behavioural models such as

those in this study can be enhanced by the ability to measure over heterogeneous operational structures. Therefore the data limitations here are less critical, since the sample size is sufficiently large and the sectoral differences provide an added dimension that is not available through a time series. This is a useful source of additional variation, although not one that introduces econometric problems.[1]

Therefore, instead of panel data analysis, numerous cross-section regressions were estimated, with the variables constructed as a five years average where available and a single year otherwise, as noted in the Tables. The general approach was to use ordinary least squares as an initial method, then to check for any econometric difficulties. The most common were heteroskedasticity, which was corrected using White standard errors, and endogeneity, discussed below.

In Chapter 6, the generalised instrumental variables estimator (GIVE), or two-stage least squares, method was used. The value of the IV estimator is fairly robust to changes in specification, although large standard errors may occur, due to a fairly low correlation between the instruments and the endogenous regressors. But, the estimators are consistent, although possibly at the expense of efficiency. One further problem in practice is that the choice of specification is not so easy to determine as there is no unique definition of R^2 or adjusted R^2 if the model is not estimated by ordinary least squares. However, where the estimates are obtained by the instrumental variables method, the goodness-of-fit is not the major objective, but rather a consistent estimation of the causal effect of corporate governance factors on performance and decision outcomes of the firm.

For the analysis in the remaining chapters, a different approach is used, although the problems with endogeneity persist and are dealt with in a similar way to that in Chapter 6.

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[1] A testable assumption is that the form of the estimating equation is the same for each firm: that is, the data must be poolable (see Baltagi (1995), Chapter 4, for a discussion of poolability tests).

However, in this section of the thesis the nature of the dependent variables means that OLS regression is inadequate (Verbeek, 2000) and instead, a range of limited dependent variable models is used. In Chapter 7, the relationship between corporate governance and decision to pursue an international strategy through FDI is examined. This is in three parts. Firstly, a dependent variable that is a binary YES/NO response and a binomial logit regression is appropriate; the second uses a count variable, for which a Poisson model is adopted; and the third is a grouped set of outcomes that is estimated as an ordered logit regression. Chapter 8 extends the study of FDI by considering choice of location, again with categorical data used in the dependent variable. Here, binary and multinomial logit are the methods of choice. All of the methods in the three empirical chapters are supported by the empirical literature. The precise specifications are presented in the appropriate chapters, but the general models are briefly discussed here, much of which is taken from Kennedy (1998), Greene (2003) and Verbeek (2000).

Binomial& Multinomial Logit

In this model, predicted values of the dependent variables are interpreted as the probability of the individual to make either choice. The logit model is based on a logistic function that constrains the estimated probabilities to be between 0 and 1, increasing the robustness of the results. As with other econometric applications of qualitative dependent variables, binomial logit is based on the hypothesis that individual will maximise personal utility and thus the choice reflects a preference set and is not simply an unexplained residual. The model is stated

$$prob(y=1) = LOGIT(X\beta) = \frac{e^{X\beta}}{1+e^{X\beta}} \qquad \textbf{5.1}$$

where y is the YES/NO choice and X is a matrix of explanatory variables and β is a

vector of estimated coefficients.

In common with other specifications using qualitative dependent variables, a linear utility maximising model is latent in the logit regression and represents the probability that the selection identified is preferred to the alternative. The latent function is stated

$$U = \mathbf{X}\beta + \varepsilon \qquad \textbf{5.2}$$

where the function is determined by a set of explanatory variables, X, β is a vector of estimated coefficients and an error term, ε. Hence, to maximise utility given choices A and B, option A will be chosen when the utility derived is greater than that of B

$$UtilityB(X_0\beta_B + \varepsilon_B) < UtilityA(X_0\beta_A + \varepsilon_A) \qquad \textbf{5.3}$$

and

$$\varepsilon_B - \varepsilon_A < X_0(\beta_A - \beta_B) \qquad \textbf{5.4}$$

Unique to qualitative dependent variables, where the error term of the individual utility function is independently and identically distributed as a log-Weibull distribution, the logit model results and is the cumulative density of the difference between any two observations. Following from 5.3, 5.4 specifies how the log-Weibull distribution of error terms determines the probability of an alternative choice. The probability that option A is chosen is given by the cumulative density of $\varepsilon_B - \varepsilon_A$ to $X_0(\beta_A - \beta_B)$. Moreover, as the cumulative density of error terms, $\varepsilon_B - \varepsilon_A$, is given by the logistic function, the logit model in 5.5 defines the probability that choice A results. However, coefficients for latent utility-functions in 5.5 cannot be estimated directly. Rather, one of the possible choices acts as a base alternative and estimated coefficients of the logit model, $(\beta_A - \beta_B)$ are determined by the difference in the coefficients between the two possible outcomes. In 5.5, B is the base alternative and A is chosen alternative.

$$prob(A) = \frac{e^{X_0(\beta_A - \beta_B)}}{1 + e^{X_0(\beta_A - \beta_B)}} \qquad \textbf{5.5}$$

In equations 5.6, 5.7, and 5.8, the multinomial logit models measure the probability an

individual chooses one option, A, B and C. Among the three options, the option C is treated as a base alternative in the analysis. With different options as base alternative, the estimated coefficients of the multinomial logit model, β, will change accordingly. On the other hand, the explanatory variables X in the multinomial logit equations consists of a set of individual characteristics for the decision maker.

$$prob(A) = \frac{e^{x\beta_A}}{1 + e^{x\beta_A} + e^{x\beta_B}} \quad \textbf{5.6}$$

$$prob(B) = \frac{e^{x\beta_B}}{1 + e^{x\beta_A} + e^{x\beta_B}} \quad \textbf{5.7}$$

$$prob(C) = \frac{1}{1 + e^{x\beta_A} + e^{x\beta_B}} \quad \textbf{5.8}$$

Poisson Regression

The second dependent variable is a measure of the number of events and are is therefore a series of non-negative integer values. Greene (2003) notes that the Poisson regression model is widely used to exploit individual choice behaviours in count data format. In this model, the Poisson distribution determines the probability of a specific number of occurrences and the Poisson parameter corresponding to this number is modelled as a function of a set of explanatory variables related to the testing event.

The primary equation of the Poisson model can be stated

$$prob(Yi = yi) = \frac{e^{-\lambda i}\lambda i^{yi}}{yi!} \quad \textbf{5.9}$$

where the probability of Y^i is predicted by a Poisson distribution with the parameter λ_i corresponding to a set of explanatory variables X. The probability 0 to y occurrences of a given outcome i is given by the Poisson function $e^{-\lambda i}\lambda i^{yi}$.

In Possion regression, both the mean and variance of the function $e^{-\lambda i}\lambda i^{yi}$ are λ_i and

the most common form of λ is loglinear, shown as

$$\ln \lambda i = \beta` \mathbf{X}i \qquad \mathbf{5.10}$$

and

$$\lambda = \exp(\mathbf{X}\boldsymbol{\beta}) \qquad \mathbf{5.11}$$

where **X** is a row vector of explanatory variables and **β** is a vector of estimated coefficients.

Ordered Discrete Choice Models

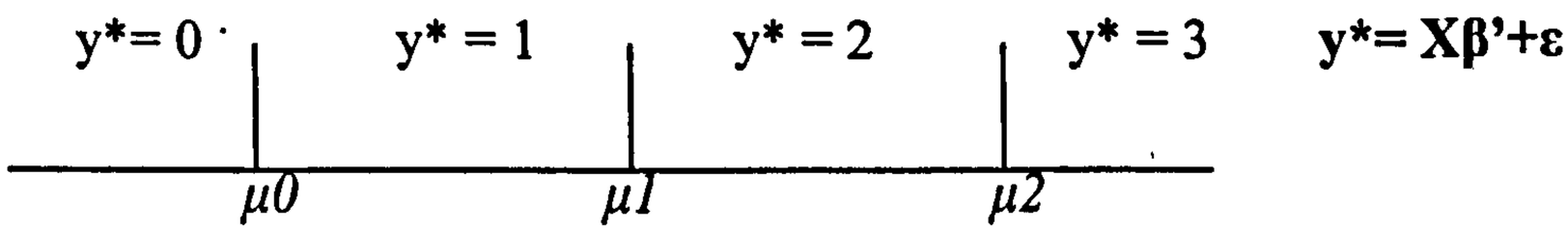
The third dependent variable of this study consists of five dummy variables that represent firm commitment to FDI, measured as set of ranked groups, in which the order must be retained. OLS or multiple choice models are not appropriate here and ordered logit, based on the logit function, is required. The latent utility function in ordered logit is stated

$$y^* = X\beta' + \varepsilon \qquad \mathbf{5.12}$$

where

$$yi = J \quad \text{if} \quad \mu_{j-1} < yi^* \leq \mu_j, \quad J=0, 1, 2, \ldots j \qquad \mathbf{5.13}$$

This is identical to the binomial logit model, where the utility y^* derived from a chosen alternative is determined by a set of explanatory variables X, and estimated coefficients β', with an error term, ε. Further, the probability an individual selects option J (0, or 1, or…j) is determined by setting criteria defined as utility levels between μ_{j-1} and μ_j within the testing frame. Particularly, in the ordered discrete choice model, all the utility values between the interval μ_{j-1} and μ_j are treated equally and coded by the responding alternative, such as 0 or 1 or…j. For example, where the firm has four ordered choices, including the option of choosing none, values of J in the 5.10 are 0, 1, 2 and 3, and the associated benefits can be placed into four categories



Thus, the probability that a specific level of FDI is undertaken fits into a single category is

$$prob(y^* = 0) = prob(X\beta' + \varepsilon < 0) = prob(\varepsilon < -X\beta')$$
$$prob(y^* = 1) = prob(0 < X\beta' + \varepsilon \leq \mu 1) = prob(-X\beta' < \varepsilon \leq \mu 1 - X\beta')$$
$$prob(y^* = 2) = prob(\mu 1 < X\beta' + \varepsilon \leq \mu 2) = prob(\mu 1 - X\beta' < \varepsilon \leq \mu 2 - X\beta')$$
$$prob(y^* = 3) = prob(\mu 2 < X\beta' + \varepsilon) = prob(\mu 2 - X\beta' < \varepsilon)$$

Assuming a model with an error term of a latent utility maximisation function has a logistic distribution, the function can estimate the probability of a occurrence of an ordered alternative. The primary equations are stated in 5.14 – 5.17, where the probability of choices from 0 to 3 are determined by the logistic function with the coefficient of the parameter of latent regression, Ω. This parameter is derived from the set of explanatory variables X and estimated coefficients β' that measures the influence of X on the probability of falling into a particular interval

$$prob(y^* = 0) = \frac{e^{\Omega(-\beta' X)}}{1 + e^{\Omega(-\beta' X)}} \qquad \textbf{5.14}$$

$$prob(y^* = 1) = \frac{e^{\Omega(\mu_1 - \beta' X) - \Omega(-\beta' X)}}{1 + e^{\Omega(\mu_1 - \beta' X) - \Omega(-\beta' X)}} \qquad \textbf{5.15}$$

$$prob(y^* = 2) = \frac{e^{\Omega(\mu_2 - \beta' X) - \Omega(\mu_1 - \beta' X)}}{1 + e^{\Omega(\mu_1 - \beta' X) - \Omega(\mu_2 - \beta' X)}} \qquad \textbf{5.16}$$

$$prob(y^* = 3) = \frac{e^{1 - \Omega(\mu_2 - \beta' X)}}{1 + e^{1 - \Omega(\mu_2 - \beta' X)}} \qquad \textbf{5.17}$$

Endogeneity

Any study of the impact of forms of corporate governance on performance and on FDI decisions, raises the issue of endogeneity. Clearly, where firm performance is the outcome of the strategic decisions made by various stakeholders, and where some of these stakeholders are involved in a firm because it is performing well, endogeneity in the

estimating equation is likely. Equally, foreign institutions may be more interested in firms that have an international profile, and thus have already made the decision to undertake FDI. Again, endogeneity is a possible outcome. In this study, the family have input into firm decisions because they are owners and have an inherent interest in the business, but financial institutions are responsible to their clients and are selective about which firms they invest in. Thus, tests of endogeneity are critical, and if positive, instrumental variables are substituted for the exogenous variables and the model re-estimated, with further tests to confirm this has been an effective way of neutralising the problem.

The general approach, known as a limited-information method for a single equation model, is as follows. Let the estimating equation be written as

$$y = \beta + \beta x_i + \beta w_i + u \qquad \textbf{5.18}$$

where the potentially endogenous variables are x_i and the truly exogenous variables are w_i. First, each of the potentially endogenous variables is regressed on the available instruments and the truly exogenous variables in the model. These single reduced form or artificial equations are estimated for each potentially endogenous variable, using OLS. In all cases, the instruments for the potentially endogenous variables, x_i, are the lagged values, $x_i(-1)$ and $x_i(-2)$, as in (2).

$$x_i = b_i + b_i w_i + b_i x_i(-1) + b_i x_i(-2) + v_i \qquad \textbf{5.19}$$

These equations give estimates $\hat{x}_i$, the predicted value of x_i and $\hat{v}_i$, the predicted value of v_i. The saved residuals are then included in the original equation, and a Wu-Hausman test (Wu, 1973, Hausman, 1978) is used to determine whether the variables are endogenous. If the δ's in (3) are jointly different from zero, then the variables are endogenous.

$$y = \beta + \beta x_i + \beta_i w_i + \delta_i \hat{v}_i + u \qquad \textbf{5.20}$$

To measure the effectiveness of the instruments, the Sargan-Basmann procedure tests whether the instruments are now independent of the errors. Using the coefficients that

were estimated from the fitted values for the endogenous variables, the error is calculated by subtracting the product of these estimated coefficients and the actual values of the dependant variable. This calculated error is then regressed on the genuinely exogenous variables and all the instruments and testing the hypothesis that these coefficients are jointly zero.

Conclusion

This chapter described various data sources of this thesis and also the measurements to define testing variables and various contextual controllers. The variables produced in this chapter will be used in the following empirical tests. This chapter also provided preliminary analysis of descriptive statistics to present the structure of data and crucial variables of this thesis. This leads to the research questions of following chapters and benefits to generate relative study hypotheses. In the final part, the econometric methodologies that will be adopted in the following empirical chapters were introduced while the details of the analytical model are left to the appropriate chapter.

Chapter Six: Corporate Governance and Firm Performance

Introduction

This chapter is the first of three empirical studies that extends the literature presented in Chapters 3 and 4 on the corporate governance impact of ownership on firm performance, with a specifically Asian focus. There is a growing body of research in the economics and management literatures that links the pattern of corporate governance with strategic decisions, and, eventually, corporate performance. However, despite this wealth of research, little is known about ownership-performance inter-relationships outside an Anglo-American environment of widely-owned public corporations. More specifically, there is a dearth of information on the determinants in family-controlled but publicly listed firms, which represent a significant part of the corporate sector in many developed and developing countries. Daily et al. (2002) note that "agency effects may function differently in this context and those prior findings from non-family samples may not readily generalise into this setting". Thus, while the approach taken here has its foundations in the established literature, additional sources are used in the development of the research questions in this empirical work on Taiwan.

Family-controlled firms play a particularly important role in Asian countries (Chang, 2003; Joh, 2003), but with the exception of Japan, most studies of corporate governance related to Asian countries prior to 1998 rely on case study methods of specific industrial sectors (for example, Taniura, 1989; Taniura, 1993; Numazaki 1993). While many have produced interesting results the overall picture of corporate governance in the region remains ambiguous.

The South-east Asian crisis has also resulted in a number of papers that have noted the effects of ownership and the increased vulnerability of a corporate sector that has high levels of family control (Piesse and Khatri, 2002; Dhnadirek and Tang, 2003). However, a number

of Asian countries did not experience a dramatic fall in economic performance during the crisis period, while still maintaining a close family ownership structure (Rajan and Zingales, 1998). This is not totally surprising, since the economic environment within countries of the region is substantially different, despite common elements such as cultural background, the nature and extent of institutions and the level of economic development. A single model of corporate governance for all of Asia is unlikely although Mitton (2002) found that governance mechanisms, especially monitoring activity, are critical to corporate performance. However, to what extent this varies across individual countries is still unclear. Thus, focusing on a single country, Taiwan, enable this thesis to examine links between family control and performance in firms operating in the same legal and institutional environments. Further, this decision permits the corporate governance study to hold constant a number of important contextual factors and avoid endogeneity problems between ownership structure and country-specific institutional characteristics (Carney and Gedajlovic, 2003; Joh, 2003).

Building on agency and institutional perspectives, this chapter makes a number of contributions. First, it analyses corporate governance effects on performance in situations where the managers are frequently family members, where families are also represented on a supervisory board, and where they are often the major providers of capital, if not directly, then through relational holdings in other firms (Bruton et al., 2003, Carney and Gedajlovoc, 2003). Second, building on an integrated research framework developed by Agrawal and Knoeber (1996) the study examines to what extent concentrated shareholdings by institutions can provide an effective counter-balance to families' opportunism and so improve firm performance, as can outsider representation on corporate boards. This concern has been neglected in previous work on Taiwan (Yeh et al., 2001). Finally, this study provides empirical analysis of governance-performance relationships using the longitudinal multi-industry dataset of 228 firms listed on the Taiwan Stock Exchange (TSE) described in

detail in Chapter 5.

Research Hypotheses

In this chapter, the aim is to examine situations where the managers are frequently family members, families are also represented on a supervisory board, and they are often the major providers of capital, if not directly, then through relational holdings in other firms (Bruton et al., 2003, Carney and Gedajlovoc, 2003). At the same time, family-controlled firms that are listed on the stock exchange also have minority shareholders to whom managers are accountable, and governance effects of an interaction of family control with external share ownership on performance, therefore, is an important research issue. The following hypotheses are constructed to tackle numerous critical aspects relevant to the research topic.

The Relationship between Family Control and Corporate Performance

Small and medium size enterprises (SMEs) comprise the majority of firms in Taiwan, probably over 90% of the total corporate sector. Thus, the family provides investment capital and controls the operations of the firm. In these cases, boards are mainly composed of family members and decisions are made within a family dominated environment. Interestingly, this structure of corporate governance is maintained even when the business is successfully expanding and obtains a listing on the TSE. Thus, in this sample, 154 (68%) of the 228 firms retain their status as family controlled enterprises.

A number of papers, particular from North America (for example, Morck et al. 1988, Smith and Amoako-Adu, 1999), express concerns about the problems associated with family control, and the increased likelihood of the abuse of managerial power. In addition, family interest may dominate over the interest of non-family shareholders, since the concentration of personal and family wealth in owner-managed firms normally creates a preference for income and for wealth preservation over other dimensions of firm performance such as maximisation

of dividend payments to outside shareholders (Carney and Gedajlovic, 2003). Finally, family control tends to shield a firm from the disciplinary pressure of the market for corporate control since concentrated share ownership reduces the probability of a hostile take-over (Gomez-Mejia et al, 2003).

However, whether families or professional managers run companies better for society in general is still open to debate. Specifically, with the extension of altruism from the family system to the firm, owners in the current generation have the tendency and obligation to reserve wealth for the next generation, particularly in a Confucian society such as Taiwan. As a result, family firms often possess longer horizons compared to non-family firms (James, 1999). Further, studies on emerging economies have uncovered specific contextual factors may contribute to governance outcomes of family control, such as the development of market institutions, the level of government involvement, industry structures, ownership patterns and enforcement of business laws (Chang and Hong, 2000; Khanna and Palepu, 1997; 2000; La Porta et al, 1998). Generally, Filatotchev et al. (2000) indicate that external monitoring in a developing country is constrained by contexts of weak legal framework, inefficient capital market and volatile product markets, thus suggests family ownership can work as counterbalance to alleviate potential problem of family control. Consequently, the retention of control by founding families may be positively associated with performance outcomes.

In addition, family control potentially provides more useful resources for corporate development, which can be an enhancement of firm value (Filatotchev and Bishop, 2002). In fact, La Porta et al. (1997) find that poorer investor protection by national legal systems is associated with smaller and more illiquid capital markets supporting the view that private finance could be vital and a scarce resource for corporate growth in these countries. In economies with immature capital markets and a few professional managers, many family firms are established by obtaining capital and human investments from families and personal networks (McConaughy et al., 2001).

Furthermore, the presence of undiversified corporate owners, such as a controlling family, can support the company in cultivating a long-term and stable relationship externally. Through business networks, uncertainties and complexity are reduced because information is shared and circulated among the participants in the network, resulting in better monitoring of activities both within and between firms. This is especially effective in East Asia where Guanxi influences commercial activities. A number of more recent empirical studies provide evidence that controlling family ownership is associated with better performance in South Korea (Chang, 2003) and Hong Kong (Carney and Gedajlovic, 2003). Yeh et al. (2001) also confirm this point for Taiwan, however, their argument is based on all family-controlled samples, rather than a comparison of the different impacts between family-controlled and widely-held companies.

This suggests an ambiguous assessment of performance effects of family ownership and control, and that the results are contingent on a specific legal and institutional environment in the country under review. Hence, two conflicting hypotheses are suggested in this study:

H.1. *Family ownership and control are positively associated with performance.*

H.2. *Family ownership and control are negatively associated with performance.*

In addition, toward the governance effect of managerial ownership, Morck et al. (1988) and McConnell & Servaes (1990) argued that any relationship to firm value can be non-linear, leading to a third hypothesis:

H.3. *The relationship between controlling family ownership and corporate performance is non-linear.*

The Role of Institutional Investors in Corporate Governance

When organisations grow, the family ownership is gradually diluted and the interests of the controlling family become less aligned with the interests of minority shareholders (Filatotchev

and Bishop, 2002). As a result, the primary interest conflict in this governance framework is not the failure of professional managers to satisfy the objectives of diffused shareholders, but rather the expropriation of minority shareholders by the family interests (Bruton et al., 2003; La Porta *et al.*, 2000a). Therefore, divestments through sales of large blocks of shares to institutional investors may be a viable alternative to ownership dispersion from the minority shareholders' point of view (Shleifer and Vishny, 1997).

A number of studies suggest that large block outside ownership can be an effective counter-balance to managerial opportunism (for example, Hoskisson et al, 1994). Companies have large groups of undiversified shareholders can play a critical leadership and monitoring role, and they have both the incentives and the means to restrain the self-serving behaviour of managers (Maug, 1998). However, little is known about the possible role of institutional investors in an environment of family-controlled firms.

In Taiwan, the relatively small capital market provides an effective constraint on institutional investors' ability to create and manage a risk-free portfolio. At the same time, institutional investors acquire shares in listed-firms that also have a substantial family block-holding (Bruton et al., 2003). When control is dissipated among several large investors, a decision to expropriate minority shareholders requires the consent of a coalition of investors, and this coalition might hold enough cash flow rights to limit expropriation of the remaining shareholders and pay the profits as efficient dividends (La Porta et al., 2000a). Accordingly, the presence of institutional investors with sufficient corporate shareholding may provide an effective counter-balance to a family's opportunism (Gomes-Mejia et al., 2003) and resolve what Young et al. (2002) call a "principal-principal" agency relationship. This suggests a fourth hypothesis:

H.4. *The volume of shares held by outside institutional investors is positively associated with firm performance.*

The Governance Effect of Independent Boards

Corporate governance research increasingly recognises that boards of directors have a central role in reducing agency problems and the relative characteristics can therefore be constructed as an effective mechanism. A number of studies try to examine governance effects of board characteristics and many of find that board independence enhances the quality of strategic decisions and firm value (for example, Brickley et al,1994; Xie et al., 2003). Yermack (1996) reports an opposite effect where the number of independent directors on the board has no impact on firm performance although the size of the board did affect corporate governance outcome significantly. On the other hand, there is a paucity of studies of this kind from countries other than the US that support the view that control of the firm is affected by the independence of board composition (Arthur, 2001; Mak and Li, 2001).

While the monitoring effect of independent directors and supervisors may be still controversial within the existing literature, the mandatory shareholding by these board members in Taiwanese public trading corporations leads to the conclusion that board independence is unlikely to exist. More generally, existing research on corporate governance in family-controlled firms in South and East Asia suggests that family members dominate the boards of directors (Bruton et al., 2003; Young et al., 2002). Management is exercised through a senior owner-manager who typically assumes the presidency of the firm and concurrently holds the top executive position and, therefore, has complete control of the firm and its decisions (Carney and Gadajlovic, 2003). This family control over boards leads to greater executive entrenchment and poorer operating performance (Anderson et al., 2003; Gomez-Mejia et al., 2001). Given an emphasis in the literature on the links between controlling coalitions of large block shareholders and the effectiveness of monitoring by the board, it is possible to suggest that independent boards are most appropriate as a mechanism which reconciles the potentially different interests of the family and outside block-holders and leads to more efficient organisational outcomes. Thus, the hypothesis is suggested:

H.5. *The extent of board independence is positively associated with performance.*

The Governance Effect of Board Ownership

Although independent directors may provide an important contribution to corporate governance, the effect is often passive and contingent on the context of corporate controllers (Golden and Zajac, 2001). On the other hand, at a critical moment of corporate development, the board of directors is required to be concerned with the long-term performance of the organization rather than short-term financial control (Baysinger and Hoskisson, 1990; Baysinger and Hoskisson, 1990; Westphal and Fredrickson, 2001). To participate actively in corporate governance, directors and supervisors need strong incentives and their shareholdings can be the best motivation (Hambrick and Jackson, 2000; Geletkanycz et al, 2001; Shivdasani and Yermack, 1999). Specifically, with the mandatory required board shareholding in listed firms in Taiwan, it is possible that within this specific context, the board shareholding has a particular effect in aligning interests of controlling families and external shareholders. Thus, the sixth hypothesis of this chapter suggests that:

H.6. *The extent of board shareholding is positively associated with corporate performance.*

Choice of Variables and Estimation Methods

Dependent Variables of Corporate Performance

Drawing on the existing literature, a number of measures of firm performance are included in this study. The ratio of Tobin's Q is the most frequent measure used in empirical corporate governance studies (e.g. Morck et al., 1988; McConnell and Servaes, 1990; Cho, 1998). The Tobin's Q ratio is defined as following equation.

i. *Tobin's Q = Market Value of Firm / Replacement Cost of the Firm's Assets*

However, according to Chang et al. (2000), a significant herding effect on the part of

investors can be found in Taiwan. Therefore, pricing on the TSE may not be efficient, which can cause Tobin's Q to be an inappropriate measure of firm performance in this market. Accordingly, three accounting measures are also used, all of which are common in the empirical literature (Demsetz and Lehn, 1985; Ang et al, 2000):

ii. *Return on Capital Employed (ROCE) = Profit before Tax / Total Corporate Issued Capital*

iii. *Return on assets (ROA) = Profit before Interest / Annual Average of Total Assets*

iv. *Return on equity (ROE) = Profit before Interest / Annual Average of Owner's Equity*

Apart from Tobin's Q and the accounting rations, corporate dividends are another possible performance measure. La Porta (2000b) notes that corporate dividend policy is significantly linked to the quality of institutional protection on investor rights and the ability of dividend payments to explain the effect on corporate governance has been proven empirically. Thus, dividends are also used as a measure of firm performance here. The performance measure of dividend used here is the sum of the cash dividend, the stock dividend and the dividend gained from capital surplus:

v. *Dividends = Cash Dividend + Stock Dividend + Gains from Capital Surplus*

Descriptive Statistics and Correlation Matrix

The correlations between dependent and independent variables and descriptive statistics are shown in Table 6.1. Most of the contextual variables are highly correlated with all five performance measures, validating the choice of these variables. But it can also be seen that only some of the corporate governance variables have significant correlations with performances. Also, the correlation matrix of the exogenous variables is in the Table and it can be seen that there are high levels between the controls and corporate governance measures. To avoid possible bias in the analysis caused by these correlations, the level values of the control variables are replaced by the natural logarithm in the following analyses.

On average, controlling families hold 17% of equity and institutional investors hold 5%. In terms of corporate control, 68% of the sample is controlled by families, 3% are state-controlled, and 11% are controlled by foreign organisations or individuals. Even compared with other Asian countries, the percentage of family controlled companies in Taiwan is extremely high. According to Claessens et al. (2000), out of nine Asian countries, only Indonesia and South Korea have similar levels of family control, whereas the extent of state control in Taiwan is second lowest after Japan. Clearly, Taiwan represents a typically Asian corporate governance model, with a combination of controlling family and minority shareholders dominating firms.

In terms of general board characteristics, only 23% of samples have a board chairman that is independent of the controlling group. However, the dual leadership structure is relatively common in Taiwan, with only 18% of the sample having the CEO serving concurrently as the board chairman. The extent of family control on the board is considerable, and on average, 44.5% of director and supervisor positions are held by controlling family. The average board shareholding in this sample is 20.67%.

Table 6.1. Mean, Standard Deviation and Correlations amongst Testing Variables

Variables	Mean	Std. Dev.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1. Capital-labor ratio	7710995	11961934	-																	
2. Employee Number	1330.27	1946.90	-0.21**	-																
3. Company Age	30.66	9.86	-0.05	0.10	-															
4. Business Group	0.36	0.48	-0.01	0.23**	-0.03	-														
5. Gearing Ratio	0.76	0.48	0.05	0.12	0.09	0.03	-													
6. Profit Margin	5.18	16.43	-0.08	0.10	-0.01	0.18**	-0.26**	-												
7. Institutional Ownership	5.34	4.87	0.04	0.23**	-0.02	0.20**	-0.07	0.20**	-											
8. Corporation Ownership	18.63	11.68	0.21**	-0.07	0.01	0.24**	0.14*	-0.02	-0.02	-										
9. Controlling Family Onwership	17.23	13.00	-0.01	-0.02	0.02	0.27**	-0.05	0.18**	-0.05	0.23**	-									
10. State-Controlled Firm	0.03	0.16	0.00	0.07	0.03	-0.12	0.05	0.03	-0.05	0.08	-0.19**	-								
11. Foreign-Controlled Firm	0.11	0.32	0.03	0.07	-0.05	0.13*	0.00	0.08	0.06	-0.04	-0.26**	-0.06	-							
12. Family-Controlled Firm	0.68	0.47	-0.02	-0.04	0.04	0.14*	-0.02	0.05	-0.03	0.13	0.57**	-0.24**	-0.52**	-						
13. Indep. Chairman	0.23	0.42	0.09	-0.02	-0.04	0.04	-0.07	0.06	0.06	-0.05	-0.30**	0.04	0.36**	-0.40**	-					
14. CEO=Chairman	0.18	0.38	0.10	-0.12	0.09	-0.21**	0.10	-0.21**	0.01	-0.02	-0.01	-0.08	-0.17*	0.13	-0.15*	-				
15. Legal Person on Boards	109.17	71.73	0.18**	-0.05	0.14*	0.23**	0.23**	-0.09	0.06	0.42**	0.11	0.02	0.06	0.07	-0.04	0.04	-			
16. Family Control on Boards	88.9	61.68	0.02	-0.06	0.17**	0.09	-0.02	0.00	-0.10	0.23**	0.49**	-0.06	-0.16*	0.43**	-0.33**	0.10	0.38**	-		
17. Total Baord Size	10.28	5.12	0.01	0.22**	0.28**	0.26**	0.07	0.05	0.13*	0.04	-0.18**	0.10	0.24**	-0.25**	0.23**	-0.22**	0.03	-0.28**	-	
18. Board Shareholding	20.67	12.48	-0.08	0.10	-0.10	0.09	-0.08	0.21**	-0.05	0.17*	0.57**	0.15*	0.13*	0.16*	-0.10	-0.16*	0.01	0.17**	-0.01	-
Dependent Variable: ROA	4.80	4.84	-0.08	0.26**	-0.21**	0.19**	-0.38**	0.40**	0.43**	-0.10	0.04	-0.05	0.16*	0.03	0.04	-0.13*	-0.17**	-0.16*	0.02	0.17*
Dependent Variable: ROCE	10.08	14.27	-0.10	0.27**	-0.19**	0.19**	-0.37**	0.36**	0.43**	-0.06	0.05	-0.02	0.12	0.05	0.02	-0.09	-0.13*	-0.16*	0.01	0.19**
Dependent Variable: ROE	5.35	8.37	-0.07	0.27**	-0.18**	0.21**	-0.42**	0.41**	0.38**	-0.07	0.08	-0.01	0.14*	0.05	0.02	-0.12	-0.18**	-0.14*	0.02	0.21**
Dependent Variable: Dividend	1.21	0.9	-0.09	0.27**	-0.33**	0.13	-0.20**	0.20**	0.44**	-0.08	-0.06	-0.03	0.17**	-0.04	0.06	-0.09	-0.17*	-0.24**	-0.02	0.07
Dependent Variable: Tobin's Q	1.58	1.59	-0.13*	0.21**	-0.27**	0.05	-0.02	0.21**	0.35**	-0.11*	-0.04	-0.02	0.18**	0.00	0.07	0.01	-0.07	-0.19**	-0.03	0.08

**Correlation is significant at 0.01 level (two-tailed)
*Correlation is significant at 0.05 level (two-tailed)

Models and Estimations

This chapter uses regression analysis, with a number of specifications estimated, tested and compared in order to select the model of best fit. The initial approach was ordinary least squares but these were all tested for endogeneity, as discussed in Chapter 5, and when this was found to be exist, instruments were used to re-estimate using a generalised instrumental variable (GIVE) technique.

The general form of the model is as follows. The five dependent variables noted above were regressed on four industry dummies, the capital/labour ratio (logarithm), the age and affiliation of the firm, the gearing level, profit margin and a number of corporate governance variables. The corporate governance factors were measures of family ownership and control and board characteristics. The estimating equation can be stated:

$$Performances = \beta_0 + \beta_1 Textiles + \beta_2 Constructions + \beta_3 Electrics + \beta_4 Services + \beta_5 Capital - Incens + \beta_6 Age + \beta_7 Affiliation + \beta_8 Gearing + \beta_9 profit + \beta_{10} C.G.Factors + e_i$$

where:

Performance = Tobin's Q, or ROA, or ROE, or ROCE, or Dividend

Textiles = Dummy Variable for Textiles Industry (1=yes, 0=no).

Construction = Dummy Variable for Construction Industry (1=yes, 0=no).

Electrical = Dummy Variable for Electrics Industry (1=yes, 0=no).

Services = Dummy Variable for Services Industry (1=yes, 0=no).

Capital-Intensity = Ln (Issued Capital / Employee Number)

Age = Age of Corporate History

Affiliation = Dummy Variable for Controller own another company in TSE (1=yes, 0=no).

Gearing = Corporate Debt / Issued Capital (Gearing Ratio)

Profit = Net Profit / Turnover (Profit Margin)

C.G Factors = Family Control (Dummy), or Family Ownership, or Institutional Ownership, or Board Independence, or Board Shareholding

Finally, the expected sign on the impact of the corporate governance factors in the model are summarised in the Table 6.2 for the six hypotheses.

Table 6.2. Expected Associations between Corporate Governance Variables and Firm Performances

	H.1	H.2	H.3	H.4	H.5	H.6
Family-Controlled Firm	Positive	Negative	-	-	-	-
Controlling Family Ownership	Positive	Negative	Non-Linear	-	-	-
Foreign Invest Fund Ownership	-	-	-	Positive	-	-
Foreign Banks Ownership	-	-	-	Positive	-	-
Domestic Invest Fund Ownership	-	-	-	Positive	-	-
Domestic Banks Ownership	-	-	-	Positive	-	-
Independent Board Chairman	-	-	-	-	Positive	-
CEO=Chairman	-	-	-	-	Negative	-
Legal Person on Baord	-	-	-	-	Positive	-
Family Control on Board	-	-	-	-	Negative	-
Board Size	-	-	-	-	Positive	-
Board Shareholding	-	-	-	-	-	Positive

Results and Interpretation

The following tables report the results of the formal hypothesis tests in this chapter.

After the initial OLS regression, the Wu-Hausman test confirmed that several variables were considered to be endogenous and so 2SLS regression with instruments was used. The endogenous variables are replaced by lagged observations for two years (identified by IV in the Table), which were then found to be satisfactory solution to the problem. Table 6.3 provides results of the 2SLS estimation. As it clearly shows, the ownership variables of foreign investing funds, foreign banks and domestic investing funds are positively and significantly related to all performance

measurements. Conversely, while the shareholding of domestic banks is negatively linked with corporate performance, the relationship is not significant. The findings in this section can directly verify the governance effect of institutional investors, especially in the case of family dominated firms, which is suggested by hypothesis 4 of this study.

Table 6.3. 2SLS Estimation of Stockholders Ownership and Firm Performance

	ROCE Model		ROA Model		ROE Model		Dividend Model		TobinQ Model	
Textiles	-0.09	-0.07	-0.08	-0.06	-0.09	-0.07	-0.11	-0.07	-0.02	0.00
	[2.36]	[2.2]	[0.77]	[0.72]	[1.34]	[1.28]	[0.14]	[0.13]	[0.28]	[0.27]
Constructions	0.00	0.07	-0.06	0.01	-0.03	0.04	-0.01	0.05	-0.15†	-0.08
	[2.72]	[2.58]	[0.89]	[0.85]	[1.55]	[1.5]	[0.16]	[0.16]	[0.32]	[0.31]
Electrics	0.15*	0.10	0.15*	0.10	0.07	0.03	0.32***	0.25***	0.34***	0.29***
	[2.56]	[2.5]	[0.84]	[0.82]	[1.46]	[1.45]	[0.16]	[0.15]	[0.30]	[0.3]
Services	0.06	0.09	0.04	0.07	0.03	0.05	0.11†	0.13*	0.03	0.05
	[2.63]	[2.53]	[0.86]	[0.83]	[1.50]	[1.47]	[0.16]	[0.15]	[0.31]	[0.31]
Ln Capital-labor Ratio	0.12	0.02	0.22***	0.14†	0.18*	0.11	0.13†	0.01	0.11	0.02
	[1.23]	[1.21]	[0.40]	[0.4]	[0.70]	[0.7]	[0.07]	[0.07]	[0.14]	[0.15]
Ln Employee Number	0.36***	0.25***	0.40***	0.31***	0.38***	0.3***	0.40***	0.28***	0.21***	0.12
	[0.99]	[0.96]	[0.32]	[0.32]	[0.56]	[0.56]	[0.06]	[0.06]	[0.12]	[0.12]
Ln Company Age	-0.14*	-0.1†	-0.17***	-0.13*	-0.16***	-0.11*	-0.27***	-0.24***	-0.21***	-0.19**
	[2.38]	[2.28]	[0.78]	[0.75]	[1.36]	[1.33]	[0.14]	[0.14]	[0.28]	[0.28]
Business Group	0.07	0.06	0.03	0.04	0.06	0.07	0.00	0.00	-0.08	-0.07
	[1.76]	[1.75]	[0.58]	[0.58]	[1.00]	[1.02]	[0.11]	[0.11]	[0.21]	[0.21]
Gearing Ratio	-0.37***	-0.35***	-0.35***	-0.34***	-0.39***	-0.38***	-0.23***	-0.21***	0.01	0.03
	[1.68]	[1.59]	[0.55]	[0.52]	[0.96]	[0.92]	[0.10]	[0.1]	[0.20]	[0.19]
Profit Margin	0.19***	0.15**	0.24***	0.2***	0.25***	0.22***	0.04	0.01	0.14*	0.11†
	[0.05]	[0.05]	[0.02]	[0.02]	[0.03]	[0.03]	[0.00]	[0.003]	[0.01]	[0.01]
Foreign Invest Funds IV		0.22***		0.19***		0.19***		0.21***		0.2***
		[0.27]		[0.09]		[0.15]		[0.02]		[0.03]
Foreign Banks IV		0.1†		0.06		0.04		0.17***		0.14*
		[0.7]		[0.23]		[0.41]		[0.04]		[0.08]
Domestic Banks		-0.02		-0.05		-0.06		-0.01		-0.05
		[0.36]		[0.12]		[0.21]		[0.02]		[0.04]
Domestic Invest Funds IV		0.22***		0.23***		0.21***		0.17**		0.15*
		[0.45]		[0.15]		[0.26]		[0.03]		[0.05]
Normal Corporation IV		0.03		0.00		0.01		0.05		-0.01
		[0.07]		[0.02]		[0.04]		[0.004]		[0.01]
Controlling Family IV		0.04		0.03		0.04		0.00		0.05
		[0.06]		[0.02]		[0.03]		[0.003]		[0.01]
Adjusted R Square	0.363	0.453	0.408	0.486	0.398	0.464	0.413	0.501	0.287	0.351

Note: All coefficients are standardised; Level of Significance: † p<=0.10, * p<=0.05, ** p<=0.01, ***p<=0.001; Standard Errors in parentheses; IV are instrumental variables.

Moreover, as Table 6.3 indicates, there is no significant association between

controlling family ownership and all measurements of performance. To explore this issue further and test for a possible non-linearity in this relationship, the family ownership is transformed into four interval dummies indicating the family shareholding on the amount of 5-15%, 15-25% and 25-35%. With the interval dummies, a piecewise linear regression is conducted. However, as the results shown in the Table 6.4, none of these dummies have any significant impact on firm performance, which eliminates the possibility that the insignificance of family ownership on firm values is caused by a non-linear relationship.

Table 6.4. OLS Estimation of Non-Linear Associations between Family Ownership and Firm Performance

	ROCE Model		ROA Model		ROE Model		Dividend Model		Tobin's Q Model	
Textiles	-0.09	-0.08	-0.08	-0.08	-0.09	-0.09	-0.11	-0.1	-0.02	-0.01
	[2.36]	[2.39]	[0.77]	[0.78]	[1.34]	[1.36]	[0.14]	[0.15]	[0.28]	[0.28]
Constructions	0	0.02	-0.06	-0.05	-0.03	-0.02	-0.01	0	-0.15†	-0.11
	[2.72]	[2.79]	[0.89]	[0.92]	[1.55]	[1.59]	[0.16]	[0.17]	[0.32]	[0.33]
Electrics	0.15*	0.17*	0.15*	0.17*	0.07	0.1	0.32***	0.33***	0.34***	0.38***
	[2.56]	[2.68]	[0.84]	[0.88]	[1.46]	[1.53]	[0.16]	[0.16]	[0.30]	[0.31]
Services	0.06	0.08	0.04	0.05	0.03	0.04	0.11†	0.12†	0.03	0.05
	[2.63]	[2.69]	[0.86]	[0.88]	[1.50]	[1.53]	[0.16]	[0.16]	[0.31]	[0.31]
Ln Capital-Labor Ratio	0.12	0.13†	0.22***	0.23***	0.18*	0.20*	0.13†	0.14†	0.11	0.1
	[1.23]	[1.27]	[0.40]	[0.42]	[0.70]	[0.72]	[0.07]	[0.08]	[0.14]	[0.15]
Ln Employee Number	0.36***	0.37***	0.40***	0.42***	0.38***	0.40***	0.40***	0.42***	0.21***	0.21*
	[0.99]	[1.02]	[0.32]	[0.33]	[0.56]	[0.58]	[0.06]	[0.06]	[0.12]	[0.12]
Ln Company Age	-0.14*	-0.15*	-0.17***	-0.17***	-0.16***	-0.15*	-0.27***	-0.27***	-0.21***	-0.21***
	[2.38]	[2.42]	[0.78]	[0.79]	[1.36]	[1.38]	[0.14]	[0.15]	[0.28]	[0.28]
Business Group	0.07	0.06	0.03	0.02	0.06	0.05	0	0	-0.08	-0.07
	[1.76]	[1.84]	[0.58]	[0.60]	[1.00]	[1.05]	[0.11]	[0.11]	[0.21]	[0.22]
Gearing Ratio	-0.37***	-0.36***	-0.35***	-0.35***	-0.39***	-0.39***	-0.23***	-0.23***	0.01	0
	[1.68]	[1.69]	[0.55]	[0.55]	[0.96]	[0.96]	[0.10]	[0.10]	[0.20]	[0.20]
Profit Margin	0.19***	0.19***	0.24***	0.24***	0.25***	0.25***	0.04	0.05	0.14*	0.13*
	[0.05]	[0.05]	[0.02]	[0.02]	[0.03]	[0.03]	[0.00]	[0.00]	[0.01]	[0.01]
Ownership 5-15%		0.09		0.08		0.08		0.07		0.01
		[2.04]		[0.67]		[1.16]		[0.12]		[0.24]
Ownership 15-25%		0.07		0.07		0.1		0.05		0.11
		[2.48]		[0.81]		[1.42]		[0.15]		[0.29]
Ownership 25-35%		0.08		0.04		0.05		0.02		0.1
		[2.83]		[0.93]		[1.62]		[0.17]		[0.33]
Ownership 35% up		0.04		0.04		0.05		0.01		0
		[2.95]		[0.97]		[1.68]		[0.18]		[0.35]
Adjusted R Square	0.363	0.359	0.408	0.402	0.398	0.393	0.413	0.406	0.287	0.289

Note: All coefficients are standardised; Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, ***p<=0.001; Standard Errors in parentheses.

On the other hand, dummies for state control, foreign control and family control for the status of sample companies are tested for their associations with firm performance. As Table 6.5 indicates, family control has positive effect on all corporate performance measures. Moreover, except for the dividend equation, all the regression coefficients for the family control dummy are significant at least at 10% level. While the family ownership did not show a significant association with firm performance, the results in this section indicate the significant relation is contingent on sufficient firm control. Accordingly, the positive association of family ownership is sustained by the result, which support hypothesis 1 and rejects hypothesis 2 of study.

Table 6.5. OLS Estimation of Controlling Status and Firm Performance

	ROCE Model		ROA Model		ROE Model		Dividend Model		Tobin's Q Model	
Textiles	-0.09	-0.09	-0.08	-0.08	-0.09	-0.09	-0.11	-0.1	-0.02	-0.02
	[2.36]	[2.36]	[0.77]	[0.77]	[1.34]	[1.35]	[0.14]	[0.14]	[0.28]	[0.28]
Constructions	0	0.01	-0.06	-0.05	-0.03	-0.02	-0.01	0	-0.15†	-0.13†
	[2.72]	[2.73]	[0.89]	[0.89]	[1.55]	[1.55]	[0.16]	[0.17]	[0.32]	[0.32]
Electrics	0.15*	0.16*	0.15*	0.15†	0.07	0.07	0.32***	0.32***	0.34***	0.34***
	[2.56]	[2.70]	[0.84]	[0.88]	[1.46]	[1.54]	[0.16]	[0.16]	[0.30]	[0.32]
Services	0.06	0.06	0.04	0.03	0.03	0.02	0.11†	0.11†	0.03	0.02
	[2.63]	[2.65]	[0.86]	[0.87]	[1.50]	[1.51]	[0.16]	[0.16]	[0.31]	[0.31]
Ln Capital-Labor Ratio	0.12	0.11	0.22***	0.21***	0.18*	0.17*	0.13†	0.13†	0.11	0.1
	[1.23]	[1.25]	[0.40]	[0.41]	[0.70]	[0.71]	[0.07]	[0.08]	[0.14]	[0.15]
Ln Employee Number	0.36***	0.36***	0.40***	0.41***	0.38***	0.38***	0.40***	0.40***	0.21***	0.21***
	[0.99]	[1.00]	[0.32]	[0.33]	[0.56]	[0.57]	[0.06]	[0.06]	[0.12]	[0.12]
Ln Company Age	-0.14*	-0.14*	-0.17***	-0.18***	-0.16***	-0.16***	-0.27***	-0.27***	-0.21***	-0.22***
	[2.38]	[2.38]	[0.78]	[0.78]	[1.36]	[1.36]	[0.14]	[0.15]	[0.28]	[0.28]
Business Group	0.07	0.05	0.03	0.01	0.06	0.04	0	-0.01	-0.08	-0.1
	[1.76]	[1.81]	[0.58]	[0.59]	[1.00]	[1.03]	[0.11]	[0.11]	[0.21]	[0.21]
Gearing Ratio	-0.37***	-0.37***	-0.35***	-0.36***	-0.39***	-0.39***	-0.23***	-0.23***	0.01	0.01
	[1.68]	[1.68]	[0.55]	[0.55]	[0.96]	[0.96]	[0.10]	[0.10]	[0.20]	[0.20]
Profit Margin	0.19***	0.18***	0.24***	0.24***	0.25***	0.24***	0.04	0.04	0.14*	0.13*
	[0.05]	[0.05]	[0.02]	[0.02]	[0.03]	[0.03]	[0.00]	[0.00]	[0.01]	[0.01]
State Controlled Firm		0.04		0		0.04		0.02		0.05
		[5.08]		[1.66]		[2.90]		[0.31]		[0.60]
Foreign Controlled Firm		0.07		0.08		0.1		0.04		0.11
		[3.04]		[0.99]		[1.73]		[0.19]		[0.36]
Family Controlled Firm		0.13†		0.11†		0.13*		0.08		0.16*
		[2.06]		[0.67]		[1.17]		[0.13]		[0.24]
Adjusted R square	0.363	0.364	0.408	0.409	0.398	0.401	0.413	0.409	0.287	0.293

Note: All coefficients are standardised; Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, ***p<=0.001; Standard Errors in parentheses.

Table 6.6 2SLS Estimation of the Interaction between Institutional Shareholding & Family Control Status

	ROCE Model		ROA Model		ROE Model		Dividend Model		Tobin's Q Model	
Textiles	-0.09	-0.05	-0.08	-0.03	-0.09	-0.04	-0.11	-0.06	-0.02	0.02
	[2.36]	[2.24]	[0.77]	[0.73]	[1.34]	[1.28]	[0.14]	[0.14]	[0.28]	[0.27]
Constructions	0	0.09	-0.06	0.04	-0.03	0.07	-0.01	0.06	-0.15†	-0.06
	[2.72]	[2.61]	[0.89]	[0.85]	[1.55]	[1.49]	[0.16]	[0.16]	[0.32]	[0.32]
Electrics	0.15*	0.12	0.15*	0.12†	0.07	0.06	0.32***	0.27***	0.34***	0.31***
	[2.56]	[2.53]	[0.84]	[0.82]	[1.46]	[1.44]	[0.16]	[0.15]	[0.30]	[0.31]
Services	0.06	0.11†	0.04	0.1	0.03	0.08	0.11†	0.15*	0.03	0.07
	[2.63]	[2.55]	[0.86]	[0.83]	[1.50]	[1.45]	[0.16]	[0.15]	[0.31]	[0.31]
Ln Capital-Labor Ratio	0.12	0.03	0.22***	0.15†	0.18*	0.13†	0.13†	0.02	0.11	0.04
	[1.23]	[1.26]	[0.40]	[0.41]	[0.70]	[0.72]	[0.07]	[0.08]	[0.14]	[0.15]
Ln Employee Number	0.36***	0.26***	0.40***	0.31***	0.38***	0.31***	0.40***	0.29***	0.21***	0.12
	[0.99]	[1.01]	[0.32]	[0.33]	[0.56]	[0.57]	[0.06]	[0.06]	[0.12]	[0.12]
Ln Company Age	-0.14*	-0.09	-0.17***	-0.10†	-0.16***	-0.08	-0.27***	-0.24***	-0.21***	-0.16*
	[2.38]	[2.36]	[0.78]	[0.77]	[1.36]	[1.35]	[0.14]	[0.14]	[0.28]	[0.29]
Business Group	0.07	0.04	0.03	0.02	0.06	0.05	0	-0.01	-0.08	-0.09
	[1.76]	[1.76]	[0.58]	[0.57]	[1.00]	[1.00]	[0.11]	[0.11]	[0.21]	[0.21]
Gearing Ratio	-0.37***	-0.35***	-0.35***	-0.34***	-0.39***	-0.37***	-0.23***	-0.22***	0.01	0.03
	[1.68]	[1.60]	[0.55]	[0.52]	[0.96]	[0.91]	[0.10]	[0.10]	[0.20]	[0.19]
Profit Margin	0.19***	0.16**	0.24***	0.21***	0.25***	0.23***	0.04	0.01	0.14*	0.12*
	[0.05]	[0.05]	[0.02]	[0.02]	[0.03]	[0.03]	[0.00]	[0.00]	[0.01]	[0.01]
Foreign Invest Funds IV		0.29*		0.39**		0.38**		0.30*		0.32*
		[0.69]		[0.23]		[0.40]		[0.04]		[0.08]
Foreign Banks IV		-0.06		-0.14		-0.22*		0.15		-0.06
		[1.52]		[0.49]		[0.87]		[0.09]		[0.18]
Domestic Banks		-0.01		-0.05		-0.06		0.04		-0.05
		[0.50]		[0.16]		[0.29]		[0.03]		[0.06]
Domestic Invest Funds IV		0.21*		0.28**		0.25**		0.15†		0.14
		[0.72]		[0.24]		[0.41]		[0.04]		[0.09]
Normal Corporation IV		0.1		0.06		0.13		0.11		0.02
		[0.10]		[0.05]		[0.08]		[0.01]		[0.02]
Controlling Family IV		0.12		0.16		0.2		0.13		0.07
		[3.81]		[1.24]		[2.17]		[0.23]		[0.46]
F. Invests IV * Family		-0.1		-0.23†		-0.22†		-0.11		-0.14
		[0.74]		[0.24]		[0.42]		[0.04]		[0.09]
F. Banks IV * Family		0.18†		0.23*		0.29**		0.03		0.23†
		[1.71]		[0.55]		[0.97]		[0.10]		[0.21]
D. Banks * Family Control		-0.01		-0.01		-0.01		-0.08		0.01
		[0.71]		[0.23]		[0.40]		[0.04]		[0.09]
D. Invests IV * Family		0.01		-0.06		-0.04		0.03		0.03
		[0.86]		[0.28]		[0.49]		[0.05]		[0.10]
Corp. IV * Family Control		-0.09		-0.07		-0.17		-0.08		-0.03
		[0.15]		[0.05]		[0.09]		[0.01]		[0.02]
Adjusted R Square	0.363	0.453	0.408	0.498	0.398	0.482	0.413	0.495	0.287	0.353

Note: All coefficients are standardised; Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, *** p<=0.001; Standard Errors in parentheses; IV are instrumental variables.

Further, Table 6.6 represents the 2SLS regression results for interactions between the family control dummy and institutional share ownership. According to the Table, the interaction between foreign banks ownership and family control dummy is highly significant related to performance measures, while the rest of the interactions do not show significance in the analysis. The result suggests those foreign banks positively moderate potential problems arisen from family control of Taiwanese business and thus enhance firm value. With the finding, hypothesis 4 that outside institution is

promising to counterbalance the abusing power of corporate controllers is further sustained, particularly in the circumstances of foreign financial institutions in the context of the family-controlled firm.

Table 6.7. OLS analysis of Board Characteristics and Corporate Performance

	ROCE Model		ROA Model		ROE Model		Dividend Model		Tobin's Q Model	
Textiles	-0.09	-0.06	-0.08	-0.05	-0.09	-0.06	-0.11	-0.08	-0.02	-0.01
	[2.36]	[2.33]	[0.77]	[0.77]	[1.34]	[1.33]	[0.14]	[0.14]	[0.28]	[0.28]
Constructions	0	0	-0.06	-0.07	-0.03	-0.04	-0.01	-0.01	-0.15†	-0.15†
	[2.72]	[2.66]	[0.89]	[0.88]	[1.55]	[1.52]	[0.16]	[0.17]	[0.32]	[0.32]
Electrics	0.15*	0.17*	0.15*	0.17*	0.07	0.09	0.32***	0.32***	0.34***	0.34***
	[2.56]	[2.58]	[0.84]	[0.85]	[1.46]	[1.47]	[0.16]	[0.16]	[0.30]	[0.31]
Services	0.06	0.05	0.04	0.03	0.03	0.02	0.11†	0.11†	0.03	0.01
	[2.63]	[2.64]	[0.86]	[0.87]	[1.50]	[1.51]	[0.16]	[0.16]	[0.31]	[0.32]
Ln Capital-Labor Ratio	0.12	0.19*	0.22***	0.29***	0.18*	0.26***	0.13†	0.18*	0.11	0.13
	[1.23]	[1.26]	[0.40]	[0.42]	[0.70]	[0.72]	[0.07]	[0.08]	[0.14]	[0.15]
Ln Employee Number	0.36***	0.42***	0.40***	0.45***	0.38***	0.43***	0.40***	0.45***	0.21***	0.25**
	[0.99]	[1.02]	[0.32]	[0.34]	[0.56]	[0.58]	[0.06]	[0.06]	[0.12]	[0.12]
Ln Company Age	-0.14*	-0.08	-0.17***	-0.11†	-0.16***	-0.09	-0.27***	-0.23***	-0.21***	-0.20**
	[2.38]	[2.50]	[0.78]	[0.83]	[1.36]	[1.43]	[0.14]	[0.16]	[0.28]	[0.30]
Business Group	0.07	0.08	0.03	0.05	0.06	0.09	0	0.01	-0.08	-0.08
	[1.76]	[1.81]	[0.58]	[0.60]	[1.00]	[1.03]	[0.11]	[0.11]	[0.21]	[0.22]
Gearing Ratio	-0.37***	-0.39***	-0.35***	-0.37***	-0.39***	-0.40***	-0.23***	-0.25***	0.01	-0.02
	[1.68]	[1.69]	[0.55]	[0.56]	[0.96]	[0.97]	[0.10]	[0.10]	[0.20]	[0.20]
Profit Margin	0.19***	0.19**	0.24***	0.23***	0.25***	0.24***	0.04	0.05	0.14*	0.15*
	[0.05]	[0.05]	[0.02]	[0.02]	[0.03]	[0.03]	[0.00]	[0.00]	[0.01]	[0.01]
Independent Chairman		-0.09		-0.08		-0.09		-0.07		-0.01
		[1.95]		[0 65]		[1.11]		[0.12]		[0.24]
CEO=Chairman		0.06		0.02		0.05		0.01		0.08
		[2.09]		[0.69]		[1.19]		[0.13]		[0.25]
***Legal Person on Board**		0.07		0.03		0		0.04		0.11
		[0.01]		[0.00]		[0.01]		[0.00]		[0.00]
****Family Control on Board**		-0.20**		-0.17**		-0.18**		-0.16*		-0.12
		[0.02]		[0.01]		[0.01]		[0.00]		[0.00]
*****Ln Total Board Size**		-0.13*		-0.12†		-0.12†		-0.12†		-0.07
		[2.04]		[0.68]		[1.17]		[0.13]		[0.25]
Total Board Shareholding		0.16**		0.12*		0.16**		0.05		0.11†
		[0.06]		[0.02]		[0.04]		[0.00]		[0.01]
Adjusted R Square	0.363	0.398	0.408	0.426	0.398	0.429	0.413	0.419	0.287	0.293

Notes: All coefficients are standardised; Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01; *** p<=0.001; Standard Errors are in parentheses.
*Legal Person on Board = % of directors + % of supervisors who are representatives of legal person.
**Family on Board = % of directors + % of supervisors who are members of controlling family
***Total Board Size = Directors' Board Size + Supervisors Size.

Table 6.7 in above provides test results with respect to the association between governance effects and board characteristics. In terms of board independence,

neither an independent chairman nor a chairman sharing a dual role as CEO provides significant relationship with any firm performance. However, the percentage of board seats held by a controlling family is negatively and significantly related to all measurements of corporate. Compared with the positive association of family ownership, the test result indicates the interference of controlling family on board structure can cause agency problems, which confirm a negative effect of the family in terms of management. Finally, board size is introduced as a control variable. As indicated in the Table, larger board size is significantly associated with poor performance. This supports the assumption that large and diverse boards may be counterproductive by not allowing sensible and efficient communication (Daily et al., 1999; Priem, 1990; Eisenhardt and Schoonhoven, 1990).

When considering the two-tier board structure in Taiwan, the relative characteristics of director and supervisor are also tested separately. As shown in Table 6.8, bigger director board size and a higher level of family control are significantly correlated with negative corporate performance, which is consistent with the above findings. Moreover, the result reveals that a "legal person" as director can significantly enhance corporate performance, particularly in the ROCE, ROA and dividend equations. This finding indicates that the relative resources and professional experience of an institution can help to bring a discipline and better governance in corporate management, while the institutions here are both internal and external to the organisations. On the other hand, none of the supervisor characteristics significantly impact on corporate performance, revealing the weak role of the supervisor in the corporate governance of Taiwan.

Table 6.8. OLS analysis of Separate Board Characteristic and Firm Performance

	ROCE Model		ROA Model		ROE Model		Dividend Model		Tobin's Q Model	
Textiles	-0.09	-0.07	-0.08	-0.06	-0.09	-0.07	-0.11	-0.08	-0.02	0.01
	[2.36]	[2.32]	[0.77]	[0.77]	[1.34]	[1.33]	[0.14]	[0.14]	[0.28]	[0.28]
Constructions	0	-0.02	-0.06	-0.09	-0.03	-0.06	-0.01	-0.03	-0.15†	-0.16*
	[2.72]	[2.63]	[0.89]	[0.87]	[1.55]	[1.51]	[0.16]	[0.16]	[0.32]	[0.32]
Electrics	0.15*	0.14†	0.15*	0.14†	0.07	0.07	0.32***	0.30***	0.34***	0.32***
	[2.56]	[2.55]	[0.84]	[0.85]	[1.46]	[1.47]	[0.16]	[0.16]	[0.30]	[0.31]
Services	0.06	0.05	0.04	0.02	0.03	0.01	0.11†	0.12†	0.03	0.02
	[2.63]	[2.61]	[0.86]	[0.87]	[1.50]	[1.50]	[0.16]	[0.16]	[0.31]	[0.31]
Ln Capital-Labor Ratio	0.12	0.21***	0.22***	0.30***	0.18*	0.27***	0.13†	0.2**	0.11	0.12
	[1.23]	[1.25]	[0.40]	[0.41]	[0.70]	[0.72]	[0.07]	[0.08]	[0.14]	[0.15]
Ln Employee Number	0.36***	0.43***	0.40***	0.47***	0.38***	0.44***	0.40***	0.46***	0.21***	0.27**
	[0.99]	[1.00]	[0.32]	[0.33]	[0.56]	[0.58]	[0.06]	[0.06]	[0.12]	[0.12]
Ln Company Age	-0.14*	-0.09	-0.17***	-0.12*	-0.16***	-0.09	-0.27***	-0.22***	-0.21***	-0.18**
	[2.38]	[2.46]	[0.78]	[0.82]	[1.36]	[1.41]	[0.14]	[0.15]	[0.28]	[0.30]
Business Group	0.07	0.05	0.03	0.02	0.06	0.06	0	-0.02	-0.08	0.11
	[1.76]	[1.83]	[0.58]	[0.61]	[1.00]	[1.05]	[0.11]	[0.11]	[0.21]	[0.22]
Gearing Ratio	-0.37***	-0.40***	-0.35***	-0.38***	-0.39***	-0.41***	-0.23***	-0.25***	0.01	0
	[1.68]	[1.68]	[0.55]	[0.56]	[0.96]	[0.96]	[0.10]	[0.10]	[0.20]	[0.20]
Profit Margin	0.19***	0.20***	0.24***	0.25***	0.25***	0.25***	0.04	0.06	0.14*	0.14*
	[0.05]	[0.05]	[0.02]	[0.02]	[0.03]	[0.03]	[0.00]	[0.00]	[0.01]	[0.01]
Independent Chairman		-0.15**		-0.13*		-0.13*		-0.11†		-0.03
		[2.01]		[0.67]		[1.15]		[0.13]		[0.24]
CEO=Chairman		0.04		-0.01		0.03		-0.01		0.07
		[2.08]		[0.69]		[1.20]		[0.13]		[0.25]
Ln Director Size		-0.18*		-0.16*		-0.16*		-0.19*		-0.21**
		[2.14]		[0.71]		[1.23]		[0.13]		[0.26]
%Director-Legal Person		0.18*		0.12†		0.1		0.16*		0
		[0.03]		[0.01]		[0.02]		[0.00]		[0.00]
%Director-Family		-0.27***		-0.26***		-0.25***		-0.20**		-0.17*
		[0.04]		[0.01]		[0.02]		[0.00]		[0.00]
Ln Superviser Size		0.01		-0.01		0		0.05		0.19*
		[2.05]		[0.68]		[1.18]		[0.13]		[0.25]
%Superviser-Legal Person		-0.08		-0.08		-0.08		-0.09		0.13†
		[0.02]		[0.01]		[0.01]		[0.00]		[0.00]
%Superviser-Family		0.01		0.03		0.02		0		0.02
		[0.02]		[0.01]		[0.01]		[0.00]		[0.00]
Total Boards Shareholding		0.14*		0.11*		0.15***		0.04		0.09
		[0.06]		[0.02]		[0.04]		[0.00]		[0.01]
Adjusted R Square	0.363	0.42	0.408	0.44	0.398	0.44	0.413	0.48	0.287	0.32

Notes: All coefficients are standardised; Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01; *** p<=0.001; Standard Errors are in parentheses.

Interestingly, after separating the characteristics of director and supervisor, the negative association of independent board chairman with firm performance becomes significant. This implies that independent senior managers in Taiwanese firms will encounter mistrust or even challenges from subordinates. There are a number of empirical studies that have confirmed that communication amongst board members is

a crucial factor in achieving decisions that enhance shareholder value (for example, Ensley et al, 2002; Schwenk, 1990a; 1990b). To achieve efficient communication, board chairman play a critical role in smoothing the strategy agenda and preventing potential conflict. However, without predominant power and prestige, the board chairman may find it difficult to win the trust of subordinates and thus fail to enhance communication efficiency. In a Confucianism society like Taiwan, the symbolism of controlling family plays a crucial role in cultivating networks outside the firm. An independent firm leader without absolute power to make decisions can hinder the company in joining any informal coalition in business and this can have a negative impact on corporate performance.

Finally, in terms of the associations between controlling variables, the test results show that electrical companies in Taiwan significantly outperform than others. By contrast, companies in traditional industries including textiles and construction are associated with worse performance. Further, responding to the finding relative to traditional industries, the companies with a longer history in Taiwan are significantly associated with worse performance. On the other hand, larger scale and higher capital-intensive firms are significantly performing better than others. In terms of financial control, the level of gearing has a negative impact on corporate value and this relationship is strongly significant. Moreover, profit margin is positively and significantly associated with firm value.

Discussion and Conclusion

Previous research on the effects of ownership structure and board characteristics on performance has been predominantly a Western, particularly Anglo-American concern. However, firms elsewhere, and in East Asia in particular, operate with a distinctive culture and in different legal and institutional environments, which may have an

important impact on the governance-performance relationships suggested by agency and strategy research. Thus, the applicability of the Western models should be tested in different context environments. Therefore this study has examined inter-relationships between general governance factors and firms' performance in the context of family-controlled and publicly listed firms in Taiwan.

Table 6.9. Summary of Testing Results

	Detecting Effect	Hypothesised Result with Firm Performance
Controlling Family		
Family Shareholding	Insignificant	Rejected H.1.
Family Control Status	Positive	Accepted H.1.
Family Control on Board	Negative	Accepted H.2.
Invervals of Family Ownership	Insignificant	Rejected H.3.
Institutional Investor		
Foreign Investing Fund	Positive	Accepted H.4.
Foreign Banks	Positive	Accepted H.4.
Domestic Banks	Insignificant	Rejected H.4.
Domestic Investing Fund	Positive	Accepted H.4.
Board Characteristics		
Independent Chairman	Insignificant	Rejected H.5.
CEO also Chairman	Insignificant	Rejected H.5.
Board Size	Negative	Rejected H.5.
Family Control on Board	Negative	Accepted H.5.
Board Shareholding	Positive	Accepted H.6.

Generally, the testing results on the hypotheses are summarised in Table 6.9 above. The two conflicting hypotheses related to the association between controlling family and corporate governance are respectively supported in different contexts – the financial commitment of a controlling family is positive for corporate value while family interference in management erodes governance efficiency. Further, the result rejects the hypothesis that controlling family ownership impacts on corporate governance in a non-linear manner. Apart from that, the positive association of institutional investor ownership and corporate performance is verified in Taiwanese

case, thus the relevant hypothesis is accepted. However, the argument that board independence enhances firm performance is not supported here, while the results indicate that the interference of a controlling family in board can hinder corporate profitability from most efficiency. Finally, the positive linkage between board shareholding and performance is supported.

Contrary to the assumption of the fast growing research in law and economics (for example, Claessens et al., 2000; La Porta et al., 1997; 1998, 2000a), the study did not find a direct association between family ownership and the abuse of power which can be detrimental to financial performance. Moreover, the results suggest that the family-controlled firms in Taiwan outperform their peers with a diffuse pattern of ownership. Recent corporate scandals and the collapse of stock markets have provided a new impetus to the debate about whether families or professional managers run companies better for society in general. These debates have resulted in the growing importance of the kind of values prevalent in family-owned companies (Anderson et al. 2003; Bruton et al., 2003; James, 1999). These results contribute to this literature by providing empirical evidence on the links between family control and performance in a specific institutional setting.

Although previous research provides ambiguous results in terms of the possible effects of external block-holders on performance, the results of this study confirm a positive and significant relationship between institutional share ownership and all performance proxies after controlling for potential endogeneity. Further, the findings from the separate board characteristics analysis validate the importance of foreign institutional investors to managerial discipline. These results are consistent with a block-holder coalition framework that suggests the incentive alignment effect of a coalition of large shareholders that is a positive relation between the cash flow stake of the controlling coalition and total firm value. In other words, the presence of

institutional investors may provide an effective remedy for the principal-principal agency relationship in family-controlled firm, especially in the absence of a market for corporate control.

The study also provides evidence of selectivity in terms of the effects of various board characteristics on firm performance. Although previous research does not generate compelling evidence supporting the positive governance effects of board independence, the findings of this study suggest that family interference over the board mechanism is detrimental to performance. In addition, the absolute number of directors seems to provide a negative effect on the performance indicators used in this study. This may be linked to investors' evaluation of board efficiency in relation to the board size, suggesting that beyond a certain threshold, this factor can compromise directors' effectiveness. Moreover, after separating the board characteristics of directors and supervisors, it was found that the governance effect of the board arises largely from directors rather than supervisors. This may imply either the function of supervisor is seriously neglected or the arrangement of supervisors is fundamentally redundant with respect to discipline.

In addition, the board characteristics of independent membership seem to affect performance in a significantly negative manner. This finding contradicts Western based research on publicly owned organisations that examines the impact of chairman independence on efficient monitoring and control of managerial discretion. However, in the context of these Taiwan firms, the chairman's connections and social capital is important, and the removal of such an individual may have a negative impact on the firm. Finally, this study represents an important step in the understanding of financial dependence, as suggested by Hambrick and Jackson (2000), by providing strong evidence of links between the financial commitment of board members and organisational performance.

Previous research has been focused on separate organisational outcomes of family/insider owners, outside block-holders and board characteristics. This chapter indicates the need to develop an integrated conceptual framework that brings together the analysis of simultaneous performance effects of various inside and outside investors, as well as their participation in corporate management through their position on the board.

However, this chapter has several limitations. Although in all regression models the inclusion of the main regressors provided an increase in the adjusted R^2, the actual level of variance of the dependent variables explained by each model was modest. However, the aim was to test the possible associations of corporate governance characteristics and performance rather than to provide a complete account of all factors that may affect performance of firms listed on the Taiwan Stock Exchange. Further, although an initial attempt has been made to take account of possible endogeneity of share ownership when examining how large, outside shareholders may affect the performance of these firms, the retained share ownership provided a very crude measurement of the power of their control. Therefore, a more refined analysis of the possible effects of different groups of outside investors should be necessary in any future study. In addition, the regression analysis provided evidence of strong links between board characteristics, financial interests and performance, but the various hypotheses tested in this study were far from comprehensive. For example, studies in the literature on networks have suggested that indirect, or third party board ties can strongly moderate the effects of board characteristics (Daily et al., 1999) and that analyses may be useful in further empirical research.

Chapter Seven: The Association between Corporate Governance and FDI Decisions

Introduction

Corporate governance mechanisms are designed to limit the potential for expropriation of shareholders by managers and thus enhance managerial efficiency and firm advantage. Therefore, it should be possible to measure the quality of governance within the firm by the strategic decision outcomes that occur. However, in recent corporate governance studies, there is a tendency to discuss the effectiveness of corporate governance by firm performance rather than on strategy decision outcomes. Theoretically, the impact of corporate governance factors on performance is a reflection of an improvement or deterioration in managerial competence. The finding of a non-linear relationship between governance factors and firm value would support this indirect relationship (see Short and Keasey, 1999; McConell and Servaes, 1995; Kole, 1995). Furthermore, the performance measures of recent corporate governance studies are usually restricted to domestic operations. Considering that companies involved in multinational operations required higher costs to maintain a similar quality of governance as do domestic operations, this international dimension cannot be ignored by measure domestic performance alone. Poor domestic performance can be even detrimental for a corporate governance study based on a country with a small domestic market and local firms that are highly dependent on an international trading environment, such as Taiwan. Following the analysis in the previous chapter, the corporate governance characteristics of publicly-listed and family controlled firms in Taiwan are further examined here. Using the same sample of firms, the analysis in this chapter examines the motivation of firms that undertake FDI in China and elsewhere.

As discussed earlier, the trading surplus from international markets was crucial in promoting the industrial transformation of the Taiwan economy after the Second World War.

To further this prosperity, many firms have made the decision to internationalise operations and gain access to overseas resources and markets. Previous research has supported the view that corporate governance is a major factor in specific strategic outcomes (for example: Pfeffer, 1972; Daily et al, 1999) and this relationship is particularly significant during periods of change within the firm (see Daily and Dalton, 1992). Based on these arguments, this chapter investigates the effect of the existing models of governance within the firm on FDI decisions. This presents a unique study of the links between governance and overseas investment in a sample of family owned and managed listed firms.

Research Hypothesis

The Role of the Controlling Family on FDI Decisions

Privately-owned Chinese family businesses, including those in Taiwan, represent the fourth most powerful economic group after North America, Japan and Europe (Kao, 1993). Within these family businesses, the values of Confucianism are highly relevant to the support of rigid hierarchies, mutual obligation and benevolent autocracy. At the same time, these family enterprises are very dependent on commercial networks to settle business activities (Wong et al., 1992; Hwang, 1995; Hamilton, 1996), and the controlling family plays a very close role in the management of the firm. Family members, particularly the head of the family, assume overall control within the firm by occupying the senior management positions. Furthermore, the controlling family arranges commercial contacts outside the firm, and takes full advantage of the experience and resources within the extended family group (Tsang, 2002). There is a high level of central authority, and, in contrast to Western-style firms, the controlling family in Taiwan has almost sole authority over the operations of the firm, and shapes administrative and strategy decisions.

In comparison to firms with widely-dispersed ownership and state-owned status, family-controlled businesses tend to have low levels of bureaucracy. This results in

flexibility for decisions to be agreed and executed, which is a valuable resource in a rapidly-changing international environment. Furthermore, given the relationship of the family with the firm, the current generation of owners has an obligation to reserve wealth for the next generation. As a result, family-controlled firms often posses longer planning horizons compared to non-family firms (James, 1999). Given the innate constraints of the domestic market, internationalisation is the preferred route to development and expansion. Based on the view that corporate controllers are aware of strategic problems and of their role in finding a solution, (Huff, 1990; Porac and Thomas, 1990; Voyer, 1993) this study predicts that family controlled firms will be more active in foreign investment. Hence, the first hypothesis is:

H.1. *The extent of family ownership and control in Taiwanese firms is positively associated with the decision to undertake FDI.*

The Role of Institutional Investors in FDI Decisions

The collection of views of disparate groups of individual shareholders is often inefficient, despite the benefits with respect to corporate governance. However, institutional investors are better able to coordinate shareholders' views (Diamond, 1984). Empirically, the impact of institutional investors on encouraging good governance has been extensively examined (for example: Young et al, 2002; Hoskisson et al, 1994; Wruck, 1989), although the issue remains highly controversial in Western economies. The results of the previous chapter suggest that the presence of outside institutional investors, with significant shareholdings, significantly enhances firm performance. However, it is likely that firms with superior performance are more likely to face limited domestic opportunities, and consider foreign expansion. Thus it is expected high levels of institutional shareholding to be associated with a greater possibility that the firm will undertake FDI.

As well as promoting firm performance, the resources provided by institutional investors can also encourage foreign investment. As suggested in the resource-based views, firms are a mechanism to combine bundles of resources to create organisational core competencies (Prahalad and Hamel, 1990; Grant, 1991; Teece, 1997). Firms with higher levels of resources will be more able to engage in foreign expansion (Trevino and Grosse, 2002; Oxelheim et al, 2001). This argument is particularly appropriate to Taiwanese firms, which are usually small-scale and less experienced, in comparison with enterprises from developed countries. External resources are crucial in order for such firms to compete internationally, and institutional investors can be the intermediary to inject such resources into the firm. Institutional investor can therefore play a significant role in fostering internalisation decisions.

Many researchers have argued that the impact of institutional investors on corporate governance is contingent on their organisational status and objectives (Woidtke, 2002; Kroszner and Strahan, 2001; Faccio and Lasfer, 2000). Empirical studies have confirmed that different policies are adopted by institutional investors, dependent on their status (Shu et at, 2002). Therefore, institutional investors can impact corporate internationalisation differently, and this can be an important factor in their association with FDI decisions. This leads to the second hypothesis:

H.2. *The ownership of outside institutional investors is positively associated with FDI decisions, while the significance of this relationship varies according to the status of the institution.*

The Association of Board Characteristics and FDI Decisions

According to upper echelon theory, the specific characteristics of the senior management team have an impact upon strategic decisions (Hambrick and Mason, 1984; Finkelstein and Hambrick,1996). Many studies (for example: Carpenter, 2002; Mueller and Barker III, 1997; Elron, 1997; Sheppard, 1994) have shown that specific features of the board of directors are

reflected in strategic decision outcomes. However, it is difficult to predict the impact of board characteristics on FDI decisions. Independence and diversity enhance management efficiency (Nemeth,1986; Bantel and Jackson, 1989; Eisenhardt and Schoonhoven, 1990), but the increasing heterogeneity causes conflict between board members that is detrimental to the quality of decisions made (Smith et al., 1994; Zenger and Lawrence,1989; O'Reilly and Flatt, 1989).

As noted in the previous chapter, firms in Taiwan operate under a two-tier board structure, with a board of directors and numerous supervisors. However, the governance system in Taiwan has been criticised on the grounds of inefficiency, largely as a result of the lack of independent board members. This lack of external discipline was found in the previous chapter to have a negative impact on performance. Here, similar ideas are tested, with respect to international investment strategies.

On the other hand, the shareholding of individual board members can be a strong incentive, not just for those committing financial resources but also intangibles such as time, knowledge, expertise and experience, which are fundamental in generating a strategy of long-term development of the firm. Where foreign expansion is the chosen strategy for firms to compete, careful decision-making is crucial and the benefits of a committed senior management are clear. Thus, a third hypothesis states:

H.3. *A board of directors that has some members independent of the family, but with higher levels of shareholding, is positively associated with FDI decisions.*

Methodology

In this study, the major explanatory variables are several corporate governance factors, in common with the previous chapter and as defined in Chapter 5. In addition, there are several contextual variables introduced as controls, again as defined in Chapter 5. The overall methodology has also been described earlier and will not repeated here, but the construction

of the dependent variables and the model specification will be outlined in the following sections.

Dependent Variables

Three different models are used, as discussed below, each addressing a different dimension of the FDI decision. For each model, two separate regression equations were estimated (one for China and one for the rest of the world). All the dependent variables were discrete rather than continuous. In the first model, the dependent variable was a binary variable to denote whether a company had undertaken FDI or not, and took the values of one or zero respectively. In the second model, the dependent variable was the cumulative number of international projects undertaken. In the China sample, the values ranged from 0 to 26 with a mean of 3.516 projects per company. In the rest of the world sample, the values ranged from 0 to 13 with a mean of 3.16 projects per company. The dependent variable in the third model measured the importance of overseas investment to the company's activities (FDI density), and was calculated by dividing the cumulative FDI at the end of 2001 by the average issued capital of the parent company over the period 1995-99. These ratios were then ranked, and distributed divided into quartiles. Values were calculated for the minimum, first quartile, mean, third quartile and maximum within this distribution. For those companies that had no FDI projects, the FDI density was denoted by 0, and there were 106 such companies in the China sample and 62 in the rest of world group. The FDI density was denoted by 1, 2, 3 or 4 for companies falling in each of the respective quartiles: a further 59 firms in the China sample were thus denoted by 1, 30 by 2, 31 by 3, and 2 by 4. In the rest of the world sample, the corresponding figures were 60, 96, 25, 43 and 4.

Contextual Variables

As described in Chapter 5, ten firm-specific control variables are used in this study, including four sectoral dummies (Textile, Construction, Electrical, Services), issued capital, employee number, company age, gearing ratio, profit margin, and Tobin's Q. In the second model, the "average size of project" was included in order to provide an implication of quality. In the third model, "issued capital" is omitted because of the high level of correlation between issued capital and the dependent variable (FDI Density).

Descriptive Statistics and Hypothetic Associations

Table 7.1 shows the descriptive statistics of the corporate governance variables and the expected associations with the FDI decision according to the hypotheses.

Table 7.1 Mean, Standard Deviation and Expected Association between Corporate Governance Variables on FDI Decision

	Mean	St. Dev	H.1	H.2	H.3
Family Controlled Firm	0.68	0.47	Positive	-	-
Controlling Family Ownership	17.59	13.3	Positive	-	-
Foreign Invest Funds Ownership	1.59	2.9	-	Positive	-
Foreign Banks Ownership	0.27	1	-	Positive	-
Domestic Invest Funds Ownership	1.84	1.9	-	Positive	-
Domestic Banks Ownership	1.63	2.12	-	Positive	-
Independent Chairman	0.23	0.42	-	-	Positive
Independent CEO	0.54	0.5	-	-	Positive
CEO=Chairman	0.18	0.38	-	-	Negative
%Controlling Family as Director	46.88	27.44	-	-	Negative
%Controlling Family as Supervisor	42.02	40.83	-	-	Negative
Director Number	8.22	4.44	-	-	Positive
Supervisor Number	2.05	1.02	-	-	Positive
Board Shareholding	20.67	12.48	-	-	Positive

Correlations

The two sections of Table 7.2 show the correlation matrices of the dependent and independent variables. According to the table, many of contextual variables are significantly correlated with FDI decisions. In contrast, significant correlations between the dependent variables and the corporate governance factors are limited, although for other variables there is a clearer

relationship. Finally, the correlations between corporate governance factors and contextual variables are weak, lessening potential heteroscedasticity and autocorrelation in the regression.

Table 7.2 Correlation Matrix (Section 1.)

	Yes/No for FDI		Project Number		Capital Commitment		(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Rest World	China	Rest World	China	Rest World	China							
(1) Textiles	-0.14*	-0.02	-0.11	-0.02	-0.12	-0.03	-						
(2) Constructions	-0.12	-0.12	-0.19**	-0.13*	-0.17**	-0.13*	-0.26**	-					
(3) Electrics	0.17**	0.00	0.41**	0.08	0.29**	0.09	-0.31**	-0.26**	-				
(4) Services	-0.01	-0.05	-0.14**	-0.09	-0.05	-0.12	-0.24**	-0.20**	-0.24**	-			
(5) Issued Capital - 1999	0.16**	-0.06	0.22**	0.19**	0.43**	0.08	-0.01	0.08	0.12	-0.10	-		
(6) Employee Number	0.17**	0.07	0.22**	0.36**	0.38**	0.23**	0.06	-0.07	0.09	-0.04	0.65**	-	
(7) Company Age	0.01	0.06	-0.10	0.10	-0.06	0.03	0.05	0.00	-0.28**	-0.02	0.03	0.10	-
(8) Gearing - 1999	0.12	-0.01	0.09	0.05	0.01	-0.03	-0.07	0.14*	0.02	-0.05	0.01	0.08	0.08
(9) Profit Margin - 1999	0.11	0.14*	0.11	0.09	0.16*	0.14*	-0.02	-0.21	0.10	0.07	0.11	0.15*	0.04
(10) FDI Value per case - Rest World	0.29**	-	0.08	-	0.59**	-	-0.07	-0.07	0.15*	0.05	0.41**	0.28**	-0.07
(11) FDI Value per case - China	-	0.63**	-	0.29**	-	0.73**	-0.05	-0.05	0.05	-0.10	0.03	0.13	0.03
(12) Tobin's Q	0.08	-0.04	0.28**	0.06	0.24**	0.07	-0.09	-0.24**	0.38**	0.00	0.20**	0.14*	-0.24**
(13) State Controlled	0.04	-0.07	0.02	-0.07	0.03	-0.04	-0.03	0.14*	-0.09	0.00	0.20**	0.07	0.03
(14) Foreign Controlled	-0.04	-0.19**	0.09	-0.11	0.01	-0.17*	-0.07	-0.09	0.31**	0.00	0.17*	0.07	-0.05
(15) Family Controlled	0.08	0.19**	-0.06	0.09	0.05	0.18**	0.06	-0.05	-0.21**	0.09	-0.16*	-0.04	0.04
(16) Controlling Family Ownership	0.03	0.12	-0.08	0.02	-0.03	0.08	0.08	-0.09	-0.21**	0.21**	-0.11	-0.02	0.02
(17) Foreign Fund Ownership	0.10	-0.01	0.10	0.07	0.15*	0.04	-0.04	-0.07	0.09	0.09	0.15*	0.12	0.06
(18) Foreign Banks Ownership	0.01	-0.07	0.07	-0.04	0.10	-0.05	-0.07	-0.03	0.12	-0.06	0.09	0.08	-0.05
(19) Domestic Banks Ownership	0.12	-0.05	0.06	0.00	0.19**	-0.04	0.03	-0.01	-0.04	0.09	0.12	0.08	0.02
(20) Domestic Fund Ownership	0.11	0.03	0.22**	0.09	0.13*	0.09	0.22**	-0.15*	-0.01	-0.10	0.02	0.06	-0.08
(21) Independent CEO	0.03	-0.17*	0.05	0.02	0.07	-0.10	-0.06	-0.04	0.20**	-0.08	0.02	0.12	0.00
(22) Independent Chairman	-0.01	-0.04	-0.03	-0.02	0.05	-0.04	-0.01	0.02	0.16*	-0.03	0.12	-0.02	-0.04
(23) CEO = Chairman	0.05	0.07	-0.03	-0.04	0.02	0.07	-0.02	0.02	0.01	-0.08	-0.12	-0.12	0.09
(24) Director Number	0.02	-0.02	0.05	0.10	0.09	-0.01	-0.01	0.01	0.03	-0.05	0.28**	0.21**	0.29**
(25) Supervisor Number	0.11	-0.08	0.12	0.03	0.20**	-0.01	-0.09	0.04	0.09	-0.12	0.27**	0.18**	0.11
(26) Family Control on Board	-0.04	0.03	-0.18**	-0.10	-0.14*	-0.01	0.20**	-0.05	-0.31**	0.13	-0.07	-0.06	0.17*
(27) Board Shareholding	-0.05	-0.06	-0.04	-0.07	-0.05	-0.06	-0.05	-0.06	-0.11	0.28**	0.04	0.10	-0.10

Note: ** Correlation is significant at the 0.01 level (2-tailed); * Correlation is significant at the 0.05 level (2-tailed).

Table 7.2 Correlation Matrix (Section 2)

	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)
(8)	-																		
(9)	-0.38**	-																	
(10)	0.06	0.10	-																
(11)	-0.04	0.09	0.19**	-															
(12)	-0.06	0.19**	0.16*	0.05	-														
(13)	0.03	0.03	0.00	-0.05	-0.02	-													
(14)	-0.06	0.08	-0.02	-0.16*	0.10	-0.06	-												
(15)	-0.02	0.05	0.07	0.17*	0.06	-0.24**	-0.52**	-											
(16)	-0.05	0.13*	-0.01	0.07	0.02	-0.19**	-0.26**	0.57**	-										
(17)	-0.02	0.07	0.08	0.01	0.20**	-0.02	-0.02	0.06	-0.03	-									
(18)	-0.02	0.09	0.06	-0.04	0.22**	-0.02	-0.01	0.04	0.05	0.00	-								
(19)	-0.05	0.11	0.15*	-0.02	0.01	0.03	0.05	-0.04	0.00	0.03	0.01	-							
(20)	-0.05	0.08	-0.02	-0.01	0.16*	-0.03	-0.01	0.05	0.06	0.10	-0.03	0.13	-						
(21)	0.08	0.05	0.07	-0.16*	0.12	0.10	0.22**	-0.30**	-0.30**	-0.03	-0.02	0.03	0.02	-					
(22)	-0.05	0.12	0.11	-0.04	0.01	0.04	0.36**	-0.40**	-0.30**	-0.02	-0.02	0.12	-0.11	0.23**	-				
(23)	0.06	-0.20**	-0.03	0.12	0.01	-0.08	-0.17**	0.13*	-0.01	0.14*	-0.06	0.01	-0.08	-0.34**	-0.15*	-			
(24)	0.09	0.08	0.03	-0.06	-0.10	0.08	0.23**	-0.25**	-0.19**	0.00	0.03	-0.02	0.05	0.17**	0.21**	-0.21**	-		
(25)	-0.06	0.13	0.05	-0.01	0.06	0.15*	0.16**	-0.16**	-0.10	0.06	0.19**	0.00	0.17*	0.16*	0.19**	-0.16*	0.61**	-	
(26)	0.03	-0.04	-0.01	0.02	-0.12	-0.06	-0.16*	0.42**	0.48**	-0.05	0.07	0.07	0.03	-0.33**	-0.33**	0.10	-0.28**	-0.23**	-
(27)	-0.13	0.17*	-0.05	-0.04	0.11	0.15*	0.13*	0.16*	0.57**	-0.06	0.03	0.05	0.04	-0.04	-0.10	-0.16*	-0.02	0.04	0.17*

Note: (8)Gearing, (9)Profit Margin, (10)FDI case value – rest world, (11)FDI case value – China, (12)Tobin's Q, (13)State Control, (14)Foreign Control, (15)Family Control, (16)Fami
Ownership, (17)Foreign Fund Ownership, (18)Foreign Banks Ownership, (19) Domestic Bank Ownership, (20)Domestic Fund Ownership, (21)Indp. CEO, (22)Indp. Chair, (23)CEO=Chai
(24)Director No, (25)Supervisor No,(26)Family on Board, (27)Board Shareholding; ** significant at the 0.01 level (2-tailed); * significant at the 0.05 level (2-tailed).

Binomial Logit Models

Binomial logit was used to analyse the decision choice of firms, that is, whether or not the firm had undertaken FDI. As stated in Chapter 5, the binomial logit is the probability that an individual firm will select one of two alternatives, where the decision is a logistic function of the explanatory variables. In equation 7.1

$$prob(y=1) = prob(Utility_1 > Utility_0) = \frac{e^{X\beta}}{1+e^{X\beta}} = \frac{e^{X(\beta_1-\beta_0)}}{1+e^{X(\beta_1-\beta_0)}} \qquad 7.1$$

y denotes the observed outcome, 1 for foreign investing company (detected alternative) or 0 for purely domestic firm (base alternative) X is a matrix of explanatory variables including the attributes of individual firms as controls, and several corporate governance factors, including ownership and control by the leading family, shareholding of institutional investors and board characteristics. Finally, β is a vector of estimated coefficients, determined by $(\beta_1 - \beta_0)$, which is the difference in the coefficients between the utility functions of two possible choice outcomes for a firm (see equation 7.2).

$$Utility_1 - Utility_0 = X\beta_1 - X\beta_0 = X(\beta_1 - \beta_0) \qquad 7.2$$

Count Data – Poisson Models

The second specification models the FDI decision in two stages, that is, whether the firm undertakes FDI at all, and if so, to what extent in terms of the number of projects. Accordingly, the dependent variable consists of a series of non-negative integer values representing the number of FDI projects, as described above. A Poisson model was used to estimate the impact of firm characteristics, corporate governance factors and controls on the observed decision outcomes.

The model is shown in equation 7.3, in which the probability of Yi is predicted by a Poisson distribution with parameter λ_i which is a utility function of a matrix of explanatory

variables X_i, as equation 7.4. In equation 7.3, the probability of 0 to y non-negative integer numbers occurring in firm *i* is given by the Poisson distribution $e^{-\lambda i}\lambda i^{yi}$, stated

$$prob(Yi = yi) = \frac{e^{-\lambda i}\lambda i^{yi}}{yi!} \qquad 7.3$$

and

$$\lambda = \exp(X\beta) \qquad 7.4$$

where X is a row vector of explanatory variables (corporate governance factors and controllers) and β is a vector of estimated coefficients.

It should be noted that Poisson regression methods have been criticised, for example Kennedy (1998), on the basis of some of the necessary assumption, the use of the model here seems particularly appropriate in this case. It is useful to include not only those firms that have chosen FDI as an expansion strategy, but also those that have not. Sample selection would be an obvious result if the purely domestic groups were not included. Furthermore, it is valuable to be able to estimate the extent of the FDI, conditional on the decision to invest internationally at all.

Ordered Discrete Choice Models

The third specification considers the density of FDI activities, using order logit. This is different from the other discrete choice models, as it reflects a ranking within the FDI firms and multiple choice models fail to reflect this. As other logit models, ordered logit model is based on the logistic function, shown in equation 7.1. However, firm outcomes are represented by series of codes conforming to an ordered sequence of available alternatives. This is discussed in more detail in Chapter 5.

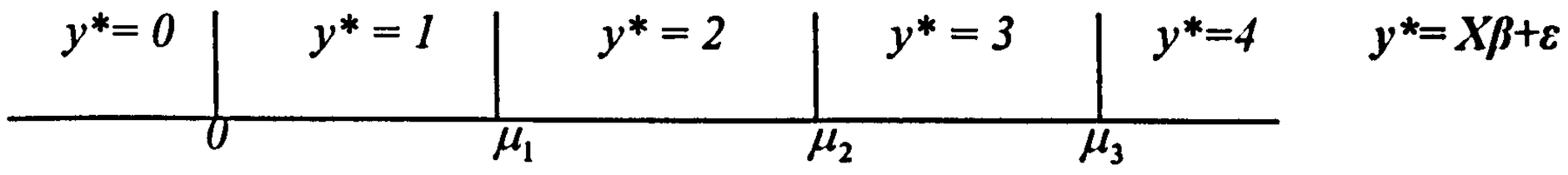
This chapter tests the effect of corporate governance on the relative importance of FDI within the firm. Four ordered choices are defined by three boundaries, μ_1, μ_2, and μ_3 (see *Dependent Variables* section), plus the decision not to undertake FDI. Accordingly, the four categories of decision are assigned values of 1 to 4 and 0 for the firms not conducting FDI at

all. Individual companies are given selected specific choices from 0 to 4, determined by the latent utility function of ordered logit, which is stated as

$$y^* = X\beta + \varepsilon \qquad 7.5$$

where $$yi = J \quad \text{if} \quad \mu_{j-1} < yi^* \leq \mu_j, \quad J=0, 1, 2,3,4 \qquad 7.6$$

yi represent the five available options for a company, *X* is the set of explanatory variables as in the previous two models (contextual controls and corporate governance factors), and β is the vector of estimated coefficients. Any utility of a firm will be locate in one of the intervals as shown below, thus the five categories of choice outcomes (0, 1, 2, 3, and 4) are achieved.



The probability that a firm achieves a specific decision outcome is estimated by the ordered logistic model with the coefficient of the parameter of latent regression, Ω. This parameter is derived from the set of explanatory variables *X* and estimated coefficients β that measure the influence of *X* on the probability of falling into a particular interval. The equations 7.6 to 7.10 present the estimations.

$$prob(y_i = 0) = prob(y^* < 0) = \frac{e^{\Omega(-X\beta)}}{1+e^{\Omega(-X\beta)}} \qquad 7.6$$

$$prob(y_i = 1) = prob(0 < y^* < \mu_1) = \frac{e^{\Omega(\mu_1-\beta'X)-\Omega(-\beta'X)}}{1+e^{\Omega(\mu_1-\beta'X)-\Omega(-\beta'X)}} \qquad 7.7$$

$$prob(y_i = 2) = prob(\mu_1 < y^* < \mu_2) = \frac{e^{\Omega(\mu_2-\beta'X)-\Omega(\mu_1-\beta'X)}}{1+e^{\Omega(\mu_1-\beta'X)-\Omega(\mu_2-\beta'X)}} \qquad 7.8$$

$$prob(y_i = 3) = prob(\mu_2 < y^* < \mu_3) = \frac{e^{\Omega(\mu_3-\beta'X)-\Omega(\mu_2-\beta'X)}}{1+e^{\Omega(\mu_2-\beta'X)-\Omega(\mu_3-\beta'X)}} \qquad 7.9$$

$$prob(y_i = 4) = prob(\mu_3 < y^*) = \frac{e^{1-\Omega(\mu_3-\beta'X)}}{1+e^{1-\Omega(\mu_3-\beta'X)}} \qquad 7.10$$

Results and Discussions

The Status of Corporate Control

The results show interesting, although at times ambiguous, effect of governance structures on FDI outcomes. Table 7.3 reports estimated coefficients and all three models indicate that there is a significant relationship between strategies directed at international investment and the systems of control with the firm. This relationship is also seen to vary depending on the destination of the FDI.

In the Table, it is clear that state-controlled firms are significantly unlikely to undertake FDI in China but they do in other foreign countries, although here, this is a weak association only. Traditionally, state-owned enterprises in Taiwan play a crucial role in the implementation of government policy. Even though most state-owned enterprises are now privatised, and many listed on the TSE, the state still holds a large proportion of equity and thus retains control of the firm. However, governmental policy is often opposed to political pressure from China, and therefore state-controlled firms are reluctant to invest in China. In contrast, to become more integrated into the international financial and business community, state-controlled firms are encouraged to invest in foreign countries. In these regressions, the signs reflect this, with a negative association in China and a positive one elsewhere. However, the significance levels are statistically rather low.

A different conclusion can be drawn for foreign-controlled firms, for FDI in China and elsewhere. Foreign control has a negative influence on FDI, and particularly so in the case of China. Since the 1960s, foreign investors have been attracted to Taiwan for cheap labour and competitive production costs. However, these investments are mostly concerned with production, which is then returned for sale on foreign markets. There are no final good export problems or barriers due to local markets. These owners are already involved with foreign commercial activity by their involvement with Taiwanese firms and are reluctant to take this any further. Particularly, the unstable relationship between Taiwan and China can

be a cause of concern for multinational enterprises. For many years, the government in Taiwan tried to position the country as a link between the West and the Chinese markets, but this has not been wholly successful.

Table 7.3. The Association between Corporate Status and FDI Decisions

	Binomial Legit		Poisson Count Data		Ordered Legit	
	Rest World	*China*	*Rest World*	*China*	*Rest World*	*China*
Textiles	-0.97†	-0.79†	-0.13	-0.55***	-0.78*	-0.67*
	(0.51)	(0.45)	(0.14)	(0.15)	(0.34)	(0.35)
Constructions	-1.27*	-1.14*	-0.51**	-0.91***	-0.78*	-0.97*
	(0.57)	(0.51)	(0.17)	(0.18)	(0.37)	(0.39)
Electrics	0.29	-0.24	0.71***	0.14	0.84*	0.36
	(0.64)	(0.52)	(0.12)	(0.13)	(0.39)	(0.41)
Services	-0.57	-1.02*	-0.26	-0.6***	-0.22	-0.66
	(0.56)	(0.5)	(0.16)	(0.18)	(0.41)	(0.41)
Issued Capital - 1999	0.00*	-0.00	0.00*	0.00†	-	-
	(0.00)	(0.00)	(0.00)	(0.00)	-	-
Employees Number	0.00	0.00	0.00*	0.00***	0.11†	0.09
	(0.00)	(0.00)	(0.00)	(0.00)	(0.06)	(0.06)
Company Age	-0.00	-0.00	0.01†	0.01**	0.11	0.01
	(0.02)	(0.06)	(0.00)	(0.00)	(0.01)	(0.01)
Gearing - 1999	0.61†	0.11	0.21**	0.22**	0.26	-0.04
	(0.34)	(0.25)	(0.07)	(0.07)	(0.21)	(0.21)
Profit Margin - 1999	0.01	0.01†	0.00	0.01*	0.00	0.01
	(0.00)	(0.01)	(0.00)	(0.00)	(0.00)	(0.01)
Average Project Value	-	-	-0.00*	0.00***	-	-
	-	-	(0.00)	(0.00)	-	-
Tobin's Q – July 1999	-0.05	-0.15	0.04†	-0.07†	0.24*	-0.09
	(0.14)	(0.11)	(0.02)	(0.04)	(0.1)	(0.09)
State-Controlled Firm	0.81	-0.29	0.47	-1.37*	0.4	-0.44
	(1.3)	(0.99)	(0.29)	(0.61)	(0.72)	(0.9)
Foreign-Controlled Firm	-0.48	-1.05†	-0.03	-0.96***	-0.41	-1.23*
	(0.64)	(0.59)	(0.16)	(0.25)	(0.48)	(0.56)
Family-Controlled Firm	0.39	0.50	0.20†	0.05	0.74*	0.73*
	(0.42)	(0.38)	(0.12)	(0.12)	(0.31)	(0.33)
Chi-square	33.59	30.75	133.58	255.59	48.06	33.27
-2 Log likelihood	233.24	284.20	-	-	-	-
Log likelihood	-	-	-463.64	-483.3	-298.56	-296.53

Note: All coefficients are standardised; Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, *** p<=0.001; Standard Errors in parentheses.

The family-controlled firms do appear to be positively associated with the FDI decision outcomes and this is particularly significant in the ordered logit model. This positive linkage may be due to the aspirations of the controlling family, where business expansion is motivated by self-interest. On the other hand, to overcome the limitations of the domestic market and to maintain their own wealth prospects, controlling families are willing to look

further afield in order to develop the firm (Carney and Gedajlovic, 2003). Investing in foreign countries to access advanced technology and cheap resources can be a possible strategy for the family-controlled firm. In any event, the particular management characteristics based on the framework of Chinese family businesses, are likely a significant increase the competence of the Taiwanese firm to actively participate in FDI. The finding supports the resource-based perspective on corporate internationalisation (Park, 2000; Fladmoe-Lindquist and Tallman, 1994; Rumelt, 1987).

The Structure of Corporate Ownership

Table 7.4 shows the linkage of firm ownership and FDI decisions. The model implies that ownership by foreign banks is negatively linked with the FDI outcomes, particular with respect to the number of FDI projects in China. Banks are by nature risk-averse, and tend to secure the interests of their clients so may well advise again foreign expansion. The presence of foreign banks is relatively new in Taiwan and their activities are still somewhat constrained, perhaps adding to their conservatism. In contrast, ownership by domestic banks indicates a significant level of encouragement of FDI in foreign countries, with the exception of China. Of course, many of the domestic banks in Taiwan are under state control and as such, are influenced by the government and thus likely to follow strategies that support policy. The state will be very keen to avoid the corporate sector being too dependent on China and so positive results for FDI in countries other than China and negative ones for China is entirely predictable. Further support for this result is that, apart from the underlying political unease, legal systems between Taiwan and China are not mutually acknowledged, for example, depositors rights that are protected in banks in Taiwan do not extend to China. This concern about the lack of legal protection can be another reason by firms with high levels of domestic bank ownership are unlikely to invest in China.

Table 7.4. The Association between Ownership Structure and FDI Decisions

	Binomial Logit		Poisson Count Data		Ordered Logit	
	Rest World	*China*	*Rest World*	*China*	*Rest World*	*China*
Textiles	-1.22*	-0.93*	-0.27†	-0.69***	-0.52*	-0.92*
	(0.55)	(0.46)	(0.14)	(0.15)	(0.21)	(0.36)
Constructions	-1.48*	-1.22*	-0.49**	-0.89***	-0.49*	-1.04**
	(0.62)	(0.51)	(0.17)	(0.19)	(0.23)	(0.4)
Electrics	-0.53	-0.6	0.67***	-0.03	0.42*	-0.11
	(0.67)	(0.50)	(0.11)	(0.13)	(0.21)	(0.38)
Services	-0.82	-1.31*	-0.34*	-0.71***	-0.2	-0.91*
	(0.64)	(0.51)	(0.17)	(0.19)	(0.24)	(0.44)
Issued Capital - 1999	0.00†	-0.00	0.00	0.00	-	-
	(0.00)	(0.00)	(0.00)	(0.00)	-	-
Employee Number	0.00	0.00†	0.00*	0.00***	0.00	0.09
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.07)
Company Age	-0.01	-0.00	0.01†	0.01**	0.00	0.001
	(0.02)	(0.02)	(0.00)	(0.00)	(0.01)	(0.01)
Gearing - 1999	0.94**	0.13	0.23***	0.26**	0.13	-0.02
	(0.36)	(0.25)	(0.07)	(0.08)	(0.13)	(0.21)
Profit Margin - 1999	0.01	0.01†	0.00	0.01**	0.00	0.01
	(0.01)	(0.01)	(0.00)	(0.00)	(0.00)	(0.01)
Average Project Value	-	-	-0.00	0.00***	-	-
	-	-	(0.00)	(0.00)	-	-
Tobin's Q – July 1999	-0.06	-0.09	0.03	-0.07†	0.13*	-0.01
	(0.16)	(0.11)	(0.02)	(0.04)	(0.05)	(0.1)
Foreign Invest Funds - IV	0.22	0.00	0.00	0.01	-0.01	-0.02
	(0.14)	(0.03)	(0.01)	(0.01)	(0.05)	(0.03)
Foreign Banks - IV	-0.16	-0.09	-0.00	-0.09†	0.00	-0.11
	(0.17)	(0.08)	(0.01)	(0.06)	(0.03)	(0.09)
Domestic Banks	0.19	-0.03	0.03†	-0.02	0.05*	-0.05
	(0.13)	(0.05)	(0.02)	(0.02)	(0.02)	(0.04)
Domestic Invest Funds - IV	-0.04	-0.00	0.06***	0.05***	0.02	0.03
	(0.11)	(0.05)	(0.01)	(0.01)	(0.02)	(0.04)
Government Agency	0.12	0.02	0.02*	-0.02	0.03†	-0.01
	(0.1)	(0.04)	(0.01)	(0.02)	(0.02)	(0.08)
Normal Corporation - IV	-0.05**	0.00	-0.00	-0.00	0.00	0.01
	(0.02)	(0.01)	(0.00)	(0.03)	(0.01)	(0.01)
Controlling Family - IV	0.01	0.02	0.01	0.00	0.01	0.02†
	(0.01)	(0.01)	(0.00)	(0.00)	(0.01)	(0.01)
Chi-square	51.48	25.57	161.39	249.85	44.68	23.26
-2 Log likelihood	215.36	289.38	-	-	-	-
Log likelihood	-	-	-449.74	-486.17	-300.25	-301.53

Note: All coefficients are standardised; Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, *** p<=0.001; Standard Errors in parentheses.

On the other hand, ownership by domestic investment funds significantly enhances the likelihood of FDI projects. Compared with foreign financial institutions, domestic investment funds have a history of experience in the commercial environment in Taiwan and thus can have stronger incentive to advice the senior management in the firms for which they have an equity interest. Unlike the banks, investment funds have a greater emphasis on

profitability and they are willing to take international opportunities even though they may present some risk, since they are able to justify this higher level of risk by their investment portfolios. This explains the statistically significant effect of domestic investment funds' positive influence on FDI decision outcomes.

Finally, the Table indicates that controlling families have a positive association with FDI, although the significance is confined to that in China. This finding reflects the view that firms with high levels of family control are more likely to undertake foreign expansion. As with previous arguments, families that can appropriate high returns from the firm tend to support foreign investment. Where they are limits to growth in the domestic environment, families can be increased wealth for themselves and for future generations in foreign opportunities, whether these are in China or elsewhere.

The findings in this part support the resource-based perspective in corporate foreign expansion (Fladmoe-Lindquist and Tallman, 1994; Tallman, 1992; Hitt et al, 1997) and validate the financial resource injected by the controlling family and domestic financial institutions that are critical in promoting internationalisation of firms in Taiwan. In contrast, the funds provided by foreign institutional investors is limited to enhance the transfer of competences to Taiwanese firms engaging in FDI.

Corporate Board Characteristics

Table 7.5 presents the impact of board characteristics on FDI decisions. Independent leadership appears to have a negative influence on FDI decisions, which is perhaps a surprising result. The explanation can be that independent chairman or CEOs have a different objective function from the controlling family. Contrary to that, independent leaders can act as a counterbalance to prevent self-interested decisions being taken by the family. Further, according to the agency perspective, independent managers tend to be risk-averse (Hill and Snell, 1988; Hill and Snell, 1989; Hoskisson et al., 1993) and thus more

likely to reject a strategy involving foreign investment projects. In particular, independent leadership in a Taiwanese firm can be a sign that the company has difficulty in settling inside disputes amongst stake-holders or family members. Therefore, independent CEO and chairman in Taiwan are often a temporary situation only, injecting a short-term aspect to decision making, while FDI tends to be a long-term strategy. The finding supports the upper echelon perspective that the characteristics of senior managers can achieve significant impacts on corporate development (Slatter, 1984; Michel and Hambrick, 1992).

Also seen in the table is the result that the number of directors has a negative association with FDI, other than for China, and this is particularly significant in the ordered logit model. This negative association can be caused by communication inefficiencies that occur with a large and heterogeneous board (see: Priem, 1990; Eisenhardt and Schoonhoven, 1990). With the exception of the China market, Taiwanese firm face a complete alien business environment. Therefore, a board with poor communication will perform less well, resulting in different outcomes, where complex decisions need to be made. By contrast, supervisor number is positively linked with FDI in the countries except for China, which is completely opposite to director number. Supervisors are generally far less numerous and thus the number may have a different effect. Rather, the more supervisors that can enhance corporate decisions, the more likely the firms are able to address the concerns of conducting production in a strange environment. These findings indicate that an intermediate board size is the most favourable (Jehn, 1994; Jehn, 1995; Amason et al., 1995; Amason, 1996), if the firm decides to undertaken corporate expansion through FDI.

Family control on the board is negatively related to FDI decisions, according to this analysis. The negative relation is particularly significant where the number of FDI projects is concerned. Unlike the resource-commitment of family ownership, high level family interfere on the board can be problematic, indicating the controlling family is keen to secure a leading role in determining management decisions. This may cause a conservative strategy,

rather than the one that undertakes risky foreign expansion. With this finding, the negative impact of family control on corporate governance has been confirmed (Morck et al., 1988; Yeh et al., 2001; Gomez-Mejia et al, 2003). Moreover, the finding verifies the reluctance of a homogenous board to generate a competitive strategy, particularly for one that is dominated by controlling manager (Hambrick and D'Aveni, 1992; Daily and Dalton, 1994b).

Table 7.5 The Association between Board Characteristics and FDI Decisions

	Binomial Logit		Poisson Count Data		Ordered Logit	
	Rest World	*China*	*Rest World*	*China*	*Rest World*	*China*
Textiles	-0.95†	-1.07*	-0.00	-0.38*	-0.61†	-0.49
	(0.53)	(0.48)	(0.14)	(0.15)	(0.36)	(0.37)
Constructions	-1.35*	-1.29*	-0.45*	-0.87***	-0.66†	-0.75†
	(0.58)	(0.53)	(0.17)	(0.19)	(0.38)	(0.41)
Electrics	-0.03	-0.77	0.73***	0.04	0.67†	0.16
	(0.62)	(0.51)	(0.13)	(0.14)	(0.39)	(0.41)
Services	-0.51	-1.28*	-0.16	0.04**	-0.02	-0.51
	(0.57)	(0.53)	(0.17)	(0.19)	(0.44)	(0.44)
Issued Capital - 1999	0.00†	-0.00†	0.00*	0.00	-	-
	(0.00)	(0.00)	(0.00)	(0.00)	-	-
Employee Number	0.00	0.00*	0.00	0.00***	0.11†	0.09
	(0.00)	(0.00)	(0.00)	(0.00)	(0.07)	(0.07)
Company Age	-0.00	-0.01	0.01*	0.02***	0.01	0.02†
	(0.02)	(0.02)	(0.01)	(0.01)	(0.01)	(0.013)
Gearing - 1999	0.68†	0.18	0.26***	0.27***	0.36†	0.14
	(0.36)	(0.26)	(0.07)	(0.08)	(0.21)	(0.21)
Profit Margin - 1999	0.01†	0.02*	0.00	0.01**	0.00	0.01
	(0.01)	(0.01)	(0.00)	(0.00)	(0.00)	(0.01)
Average Project Value	-	-	-0.00	0.00***	-	-
	-	-	(0.00)	(0.00)	-	-
Tobin's Q – July 1999	-0.05	-0.07	0.04†	-0.02	0.26**	-0.00
	(0.14)	(0.11)	(0.02)	(0.04)	(0.1)	(0.09)
Independent CEO	-0.14	-0.99**	-0.11	-0.13	-0.1	-0.61*
	(0.39)	(0.35)	(0.11)	(0.12)	(0.28)	(0.29)
Independent Chairman	0.04	0.17	-0.35**	-0.24	-0.05	-0.07
	(0.45)	(0.38)	(0.13)	(0.15)	(0.33)	(0.34)
CEO = Chairman	0.48	0.08	-0.07	-0.36*	0.27	0.34
	(0.5)	(0.44)	(0.14)	(0.16)	(0.36)	(0.37)
Directors Number	-0.07	0.04	-0.02	0.00	-0.07†	-0.03
	(0.05)	(0.05)	(0.02)	(0.02)	(0.04)	(0.04)
Supervisors Number	0.2	-0.25	0.15**	-0.02	0.28†	-0.01
	(0.21)	(0.18)	(0.05)	(0.07)	(0.16)	(0.17)
Controlling Family on Boards	-0.42	-0.00	-0.00†	-0.00*	0.00	-0.00
	(0.78)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Board Shareholding	0.00	-0.02	0.00	-0.01	-0.00	0.00
	(0.01)	(0.01)	(0.00)	(0.00)	(0.01)	(0.01)
Chi-square	34.74	34.84	143.57	241.65	43.53	22.99
-2 Log likelihood	232.09	280.11	-	-	-	-
Log likelihood	-	-	-458.65	-490.28	-300.83	-301.67

Note: All coefficients are standardised; Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, *** p<=0.001; Standard Errors in parentheses.

Although the results in the previous chapter show that board shareholding can impact the performance of the firm significantly, the opposite result is found here. It has been argued that the board shareholding is an incentive to motivate directors and supervisors to act in a manner conducive to good corporate governance (Hambrick and Jackson, 2000; Boyd and Finkelstein, 2001), especially where strategy decisions are relating to long-term development (Baysinger and Hoskisson, 1990). However, the finding in this part proves that FDI decisions are independent from this financial incentive of board members.

Robustness Tests

These results have revealed that features of corporate governance can be influential on FDI decisions. However, as indicated above, these effects differ, depending on whether FDI is in China or elsewhere. One particular positive effect of family control on FDI is found to be inherent self-interest and accordingly, investments tend to be located where production costs are low or there are tax advantages. Also, this impact is determined by whether the location of the FDI. This sensitivity can be examined further by considering the non-China models. Two additional location variables were introduced, one representing location in a tax-haven country and the other in Singapore/Hong Kong. These results are in Table 7.6.

The estimated coefficients show that both these variables are positive and highly significant, both in terms of the number of FDI projects and the value of foreign investment as a proportion of total. This suggests that operations that are part of a tax minimisation strategy are found in this sample. In addition, the political disputes between Taiwan and China, means it is more secure for Taiwanese firms to enter the Chinese markets through a third country, and the neighbouring countries of Singapore and Hong Kong can enable them to realise this advantage. Thus, inward FDI to Singapore and Hong Kong may be a step towards China, rather than FDI motivated by the desire to open production operations in a foreign location because of cost advantages.

Table 7.6. The Association between Location Choice and FDI Decisions

	Binomial Logit			Poisson Count Data			Ordered Logit		
Textiles	-0.43	-1.9	-0.83	-0.13	-0.16	-0.05	-0.8*	-0.47*	-0.47*
	(1.21)	(1.71)	(1.46)	(0.14)	(0.15)	(0.14)	(0.36)	(0.22)	(0.22)
Constructions	-1.65	-2.6	-3.73†	-0.42*	-0.43*	-0.4*	-0.80*	-0.53*	-0.53*
	(1.46)	(1.88)	(1.99)	(0.17)	(0.18)	(0.18)	(0.4)	(0.24)	(0.24)
Electrics	0.9	-1.3	0.04	0.17	0.18	0.21	0.32	0.06	0.06
	(1.25)	(1.82)	(1.57)	(0.14)	(0.12)	(0.13)	(0.42)	(0.22)	(0.22)
Services	1.58	1.77	0.54	-0.31†	-0.33*	-0.31†	-0.2	-0.09	-0.09
	(1.27)	(1.81)	(1.52)	(0.16)	(0.17)	(0.17)	(0.43)	(0.25)	(0.25)
Issued Capital - 1999	0.00†	0.00	0.00*	0.00	-0.00	0.00	-	-	-
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	-	-	-
Employee Number	-0.00	-0.00	-0.00	0.00*	0.00**	0.00†	0.10	0.00	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.07)	(0.00)	(0.00)
Company Age	-0.03	-0.04	0.01	-0.01***	-0.01***	-0.01*	-0.03	-0.02**	-0.02**
	(0.04)	(0.06)	(0.06)	(0.00)	(0.00)	(0.01)	(0.01)	(0.06)	(0.06)
Gearing - 1999	0.57	1.34	1.11	0.04	0.07	0.06	-0.12	-0.02	-0.02
	(0.98)	(1.46)	(1.41)	(0.07)	(0.07)	(0.07)	(0.23)	(0.13)	(0.13)
Profit Margin - 1999	0.05	0.04	0.09	0.00	0.00	0.00	0.00	-0.00	-0.00
	(0.04)	(0.03)	(0.06)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Average Project Value	-	-	-	-0.00	-0.00	-0.00	-	-	-
	-	-	-	(0.00)	(0.00)	(0.00)	-	-	-
Tobin's Q – July 1999	-1.07†	-2.57†	-1.82†	-0.01	-0.00	-0.02	0.18†	0.12*	0.12*
	(0.64)	(1.46)	(0.95)	(0.03)	(0.02)	(0.03)	(0.10)	(0.06)	(0.06)
State-Controlled Firm	-5.86	-	-	0.09	-	-	-0.18	-	-
	(59.27)	-	-	(0.28)	-	-	(0.77)	-	-
Foreign-Controlled Firm	-0.56	-	-	-0.03	-	-	-0.53	-	-
	(1.4)	-	-	(0.17)	-	-	(0.53)	-	-
Family-Controlled Firm	-0.8	-	-	-0.05	-	-	0.54	-	-
	(0.96)	-	-	(0.12)	-	-	(0.33)	-	-
Foreign Invest Funds Ownership	-	0.33	-	-	-0.01	-	-	-0.03	-
	-	(0.39)	-	-	(0.01)	-	-	(0.02)	-
Foreign Banks Ownership	-	0.1	-	-	-0.01	-	-	-0.01	-
	-	(0.33)	-	-	(0.012)	-	-	(0.03)	-
Domestic Banks Ownership	-	0.51*	-	-	0.02	-	-	0.07**	-
	-	(0.23)	-	-	(0.02)	-	-	(0.03)	-
Domestic Invest Funds	-	0.11	-	-	0.02*	-	-	-0.01	-
	-	(0.22)	-	-	(0.01)	-	-	(0.02)	-
Government Agency Ownership	-	0.94	-	-	0.02*	-	-	0.02	-
	-	(0.76)	-	-	(0.01)	-	-	(0.02)	-
Normal Corporation Ownership	-	-0.06	-	-	-0.00	-	-	-0.00	-
	-	(0.04)	-	-	(0.00)	-	-	(0.01)	-
Controlling Family Ownership	-	-0.04	-	-	-0.00	-	-	0.01	-
	-	(0.05)	-	-	(0.00)	-	-	(0.01)	-
Independent CEO	-	-	1.02	-	-	0.12	-	-	-0.03
	-	-	(1.17)	-	-	(0.11)	-	-	(0.02)
Independent Chairman	-	-	2.72*	-	-	-0.23†	-	-	-0.01
	-	-	(1.34)	-	-	(0.13)	-	-	(0.03)
CEO = Chairman	-	-	-0.28	-	-	-0.01	-	-	0.07**
	-	-	(1.52)	-	-	(0.14)	-	-	(0.03)
Directors Number	-	-	-0.46*	-	-	-0.00	-	-	-0.01
	-	-	(0.22)	-	-	(0.02)	-	-	(0.02)
Supervisors Number	-	-	0.93	-	-	-0.04	-	-	0.02
	-	-	(0.73)	-	-	(0.06)	-	-	(0.02)
Controlling Family on Board	-	-	-0.00	-	-	-0.00	-	-	-0.00
	-	-	(0.01)	-	-	(0.00)	-	-	(0.01)
Board Shareholding	-	-	0.03	-	-	0.00	-	-	0.01
	-	-	(0.04)	-	-	(0.00)	-	-	(0.01)
Tax Haven dummy	26.95	24.49	41.5	1.17***	1.14***	1.18***	2.51***	1.50***	1.50***
	(37.01)	(54.2)	(54.18)	(0.11)	(0.11)	(0.12)	(0.28)	(0.16)	(0.16)
Sing/HK dummy	17.04	22.37	20.17	0.86***	0.88***	0.88***	1.25***	0.71***	0.71***
	(70.37)	(73.59)	(85.47)	(0.1)	(0.1)	(0.1)	(0.29)	(0.16)	(0.16)
Chi-square	216.3	231.39	225.1	350.35	368.22	357.17	139.41	140.76	140.76
-2 Log likelihood	50.54	35.45	41.74	-	-	-	-	-	-
Log likelihood	-	-	-	-355.26	-346.33	-351.85	-252.9	-252.21	-252.21

Note: All coefficients are standardised; Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, *** p<=0.001; Standard Errors in parentheses.

Table 7.7 compares the results with and without the two location dummy variables. The hypothesised associations of family control on firms, the number of supervisors and the extent of family members on the board of directors are insignificant when the location variables are included, so the locations variables are the stronger of the influences. Specifically, for the most fundamental decision relating to FDI, should the firm undertake this strategy or not, add the two location controls seems to generate a stronger corporate governance effect. However, for the more sophisticated decisions about number of projects or relative levels of commitment, the corporate governance effect is constrained. These findings support the view that the corporate governance effect on FDI decisions is determined by the location of that investment. This will be investigated in more detail in the next chapter, where the emphasis is firmly on internationalisation strategies.

Table 7.7 Corporation Governance Effects with/without Location Control

	Binomial Logit		Poisson Count Data		Ordered Logit	
	No Controls	*Controls*	*No Controls*	*Controls*	*No Controls*	*Controls*
State Controlled	-	-	-	-	-	-
Foreign Controlled	-	-	-	-	-	-
Family Controlled	-	-	+†	-	+*	-
Foreign Invest Fund	-	-	-	-	-	-
Foreign Banks	-	-	-	-	-	-
Domestic Banks	-	+*	+†	-	+*	+**
Domestic Invest Fund	-	-	+***	+*	-	-
Government	-	-	+*	+*	+†	-
Corporation	-**	-	-	-	-	-
Controlling Family	-	-	-	-	-	-
Independent CEO	-	-	-	-	-	-
Independent Chairman	-	+*	-**	-†	-	-
CEO = Chairman	-	-	-	-	-	-
Directors Number	-	-*	-	-	-†	-†
Supervisors Number	-	-	+**	-	+†	-
Family on Board	-	-	-†	-	-	-
Board Shareholding	-	-	-	-	-	-

Note 1: All coefficients are standardised; Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, *** p<=0.001.

Conclusions

This chapter considered the impact of corporate governance factors on the decision to undertake foreign investment, using a number of measures of the extent of that investment, and matching the precise research questions with the appropriate estimating specification. The summary of these results is given in Table 7.8.

Table 7.8 Summary of Hypotheses Examination Results

	FDI Decisions		Hypothesis Examination Results
	China	Overseas	
Controlling Family			H.1. Positive Effect of Controlling Family
Family Control Status	Positive	Positive	Accepted
Family Shareholding	Positive	Insignificant	Accepted
Family Control on Board	Negative	Negative	Rejected
Institutional Investor			H.2. Positive Effect of Outside Institutional Investors
Foreign Investing Fund	Insignificant	Insignificant	Rejected
Foreign Bank	Negative	Insignificant	Rejected
Domestic Bank	Insignificant	Positive	Accepted
Domestic Investing Fund	Positive	Positive	Accepted
Board Characteristics			H.3. Positive Effect of Board Independence & Shareholding
Independent CEO	Negative	Insignificant	Rejected
Independent Chairman	Insignificant	Negative	Rejected
Board Shareholding	Insignificant	-	Rejected

The first hypothesis suggested a positive the relationship between the controlling family and FDI decisions and the data supported this. While private resources provided by controlling families enhance corporate foreign expansion, the association can be conservative when the family overwhelmingly dominate the board of directors. The second hypothesis suggested a positive effect of outside institutional investors on FDI decisions. This too was supported, although there was a difference between foreign and domestic institutions. Finally, the third hypothesis suggested that an independent chairman would have a positive impact on FDI decision, but this was rejected. Although the previous chapter confirmed board shareholding to be a positive influence on firm performance positively, this is not extended to decisions on international operations.

The effect of specific board characteristics is highly controversial in much of the existing literatures. This, the results found here are at present confined to these Taiwanese data. However, it is not surprising the results do not conform to accepted theory. The structure of ownership and control in a country where family dominated firms are listed on the exchange is likely to be different from the diverse-shareholding in western economies.

In this chapter, the impacts of various corporate governance variables on FDI decisions have been examined. There is a paucity of research into the international strategies of owner-controlled family firms, such as these in Taiwan. Previous research has investigated decisions about FDI, but all focussing on Western economies, where corporate governance mechanisms are complete and transparent. The extension of these established theories to an entirely different environment raises some interesting questions. The next chapter extends this analysis further by examining the influences related to corporate governance structures that may impact location decisions in much greater detail.

Chapter Eight: The Association between Corporate Governance and FDI Location

Introduction

Given the inherent limitations of the domestic market, Taiwanese firms rely heavily on foreign trade to maintain corporate growth and development. However, since the late 1980s, exports have suffered due to the strong domestic currency and increasing production costs and many firm's found their previous comparative advantage was gradually diminishing. Thus, many firms in Taiwan have adjusted their strategy to include a more robust approach to FDI.

One of the critical factors in the decision to undertake FDI is the choice of location, addressed to an extent in the previous chapter. Buckley (1996) noted that FDI is a major strategic decision, which can lead to increased profitability. In the vast majority of cases, the FDI decision is motivated by either the need to access cheap resources or consumer markets. As discussed in the literature review, while few studies link FDI decision outcomes and location choice to corporate governance, numerous studies show that governance characteristics can significantly impact corporate decision-making (for example: Berger and Ofek, 1995a; 1995b). Trevino and Grosses (2002) showed that several aspects of governance can impact firm level efficiency and these can be extended to FDI decisions. The analyses in the previous chapter have shown that corporate governance factors can impact FDI decisions. This chapter extends this analysis by examining the extent to which the location of the FDI activity can be influenced by the model of corporate governance that exists within the firm.

It has already been established that in this sample, corporate governance is dominated by the controlling family and the owner-managers typically assume the overall management of the firm, frequently assuming complete control. Thus, it is not unreasonable to suggest that this group will exert a considerable influence on FDI decisions (Carney and Gadajilovic,

2003). Therefore, in this particular context, all strategic decisions effecting FDI, including location choice, will be made by the dominant family. Thus, this chapter contributes to the literature on FDI by investigating the corporate governance characteristics that have an impact on location choice for those firms that choose to undertake FDI.

Research Hypotheses

The Association between of Family Control and FDI Location Choice

According to Claessens et al. (2000), publicly-listed companies in many East-Asian countries are managed by founding families, and Taiwan is no exception. With the power associated with this dominant position, family members' preferences can easily interfere in corporate strategy decision and settle the outcome (Lyles and Schwenk, 1992; Prahalad and Bettis, 1986). This is not surprising in a developing country, where traditionally, the firm depends on resources provided by the family to undertake any corporate restructuring to enhance efficiency (Bruton et al, 2003; Carney and Gedajlovic, 2003; Filatotchev and Bishop, 2002; McConaughy et al, 2001). Therefore, this simply reflects any other principal and agent relationship, where the suppliers of capital have an input into the use to which these funds are allocated (Wong et al., 1992; Hwang, 1995; Hamilton, 1996). The interesting question is whether cultural and other influences that families bring to the decision of FDI location choice fit strictly within the models prevalent in less family dominant firms.

In terms of FDI location choice, previous studies have argued that managerial preferences can be an important factor (Johanson and Vahlne, 1977; Sethi et al., 2002). , Using a sample of Chinese-style family businesses where companies tend to draw upon the overseas experience and knowledge within the family, empirical studies have detected self-interested behaviour in FDI strategy (Tsang, 2002). To enhance the inherent knowledge base and reduce risk, the controlling family may prefer a familiar location or one where close family are already established in their investment choices. The relational networks

associated with Guanxi have been widely adopted by Chinese family businesses in various forms of commercial activity. Applying the Guanxi network to FDI strategy, the controlling family in Taiwan may show a strong preference for investment in areas where there are long-term relationships between the controlling family and the local community. Thus, the first hypothesis in this chapter is:

H.1. *For Taiwanese firms, the extent of family ownership and control is positively associated with FDI location choices that reflect family links.*

On the other hand, the altruism with regard to family members stressed by the traditional Confucian society can also as a strong incentive for current controlling family members to pass on the wealth derived from the firm to the next generation. This can influence long-term strategy, including FDI location decision, particularly in terms of the acquisition of technology available in developed countries. Much of the growth of the Taiwanese economy has been due to the ability of the country to make the transition from a low cost producer to a world-class brand and the investment in advanced countries has assisted in this. Therefore, the next hypothesis suggested is:

H.2. *For Taiwanese firms, the extent of family ownership and control is positively associated with FDI location choices in advanced countries.*

Another issue of importance to the current and future wealth of the firm is the extent of tax liability. To smooth the transfer of controlling rights to the next generation, the location of FDI may feature the benefits of a tax shelter. Hence, the third hypothesis suggested is:

H.3. *For Taiwanese firms, the extent of family ownership and control is positively associated with FDI location choice in the tax-haven countries.*

The Role of Institutional Investors in FDI Location Choice

Compared with other investors, the financial institutions are more sophisticated in their choice of target firms and their ability to assess the future value of those firms. Thus, many studies argue that the institutional investors with block shareholdings that represent the interests of minority investors can play a significant role in ensuring good standards of corporate governance, especially where there are controlling families (Hansmann, 1996; Shleifer and Vishny, 1997). Particularly, for a publicly-listed company with a dominant founding family, the primary agency problem is the expropriation of minority shareholders by the family (Bruton et al., 2003; Young et al, 2002; La Porta et al, 2000a). The participation of institutional investors can be an effective force in corporate governance to restrain corporate strategy from opportunism (Maug, 1998; Hoskisson et al., 1994; Zeckhauser and Pound, 1990; McConnel and Servaes, 1990), provide a counterbalance to the agency problem. In addition, the subjective opinion from an outside institutional investor can be beneficial in enhancing the quality of strategic decision-making (Amason et al., 1995; Amason, 1996; Jehn, 1995).

In comparison with foreign competitors, many Taiwanese companies have only begun to undertaking FDI recently. Therefore the involvement of institutional investors can compensate for any lack of experience in the firm, assisting them to adapt to foreign environments (Nemeth, 1986; Eisenhardt and Schoonhoven, 1990). This can be a valuable asset, strengthening confidence and improving the outcomes for firms facing highly competitive markets abroad. In addition, for firms in an emerging country such as Taiwan, maintaining a good relationship with a major financial institution can help in the acquisition of external finance, which is essential for international expansion (Oxelheim et al, 2001).

However, in empirical research, these issues are still not commonly resolved and much ambiguity remains. Some studies even argue that outside institutional investors tend to concur with senior managers within the firm and are thus unable to perform as efficient monitors (Woidtke, 2002; Faccio and Lasfer, 2000; Admati et al., 1994). Following this argument, the institutional investor can concede to the decision of the dominant family and

encourage conservatism as an overriding strategy. Indeed, financial institutions tend to be risk-adverse (Woidtke, 2002) and therefore will advise against potentially uncertain investments abroad. This risk aversion is compounded by the inexperience and reluctance of Taiwanese firms to undertake FDI at all. Given the arguments above, the governance effects of institutional investors can be hindered by concerns about the choice of FDI location. Therefore, two conflicting hypotheses are suggested:

H.4. *For Taiwanese firms, the extent of ownership and control by outside institutional investors is positively associated with the choice of FDI location in developed countries, and*

H.5. *For Taiwanese firms, the extent of ownership and control by outside institutional investors is not associated with the choice of FDI location.*

The Association between Board Characteristics and FDI Location Choice

The board of directors is an important internal mechanism to ensure the protection of shareholders' interests. Many studies have argued that the characteristics of the board can impact the effectiveness of corporate governance (for example: Xie et al, 2003; Young et al, 2002; Daily et al, 1999; Yermack, 1996; Brickley et al, 1994), with each of these emphasizing the governance effects of leadership, composition, size and ownership structure. Further, board characteristics have been widely adopted in empirical tests related to the top management team (TMT) (for example: Daily and Schwenk, 1996; Mueller and Barker, 1997). In these studies, board characteristics are used in tests of strategic decision outcomes and are found to be significant in numerous cases (for example: Michel and Hambrick, 1992; Zahra and Pearce, 1989; Bantel and Jackson, 1989). Furthermore, a number of authors argue that in a crucial transition phase of corporate development, the board characteristic can even perform an active role in ensuring good corporate governance (Daily and Dalton, 1992; Warther, 1998; Filatotchev and Bishop, 2002). This leads to the proposition that board

characteristics are influential in determining strategies related to FDI location.

In previous studies, heterogeneity in board composition result from independent directors and was found to be positive with respect to corporate governance (Brickley et al, 1994; Priem, 1990). Thus, the composition of boards in Taiwan, where that board is independent from the controlling family, is likely to be heterogeneous and high quality strategic decision will result. Particularly, Taiwanese firms rely on the foreign markets of North America and Europe to develop and build up direct access to the market, achieving greater efficiency. However, to survive in the highly competitive environment of advanced markets, Taiwanese firms need the vision and knowledge to generate a flexible strategy. A board that is composed of members that are independent of the controlling family is necessary. Thus, the following hypothesis is suggested:

H.6. *Boards that are composed of members independent of the controlling family are positively associated with FDI location choice in advanced countries.*

Board size can be also a critical factor in determining the quality of corporate governance and a number of studies show a positive relationship between the number of members on the board, which contributes to diversity, and good practice (Nemeth,1986; Bantel and Jackson, 1989; Eisenhardt and Schoonhoven, 1990). However, there are limits to this and beyond a certain threshold, the efficiency of communication can be diminished until it is detrimental to quality strategic decisions (Daily et al, 1999; Shivdasani and Yermack, 1999; Smith et al., 1994; Zenger and Lawrence, 1989). This is a dilemma as where where there is considerable uncertainty, such as may arise in discussions of FDI location with a number of unfamiliar and worrying environments, the decision process may be made more difficult by the communications problems associated with a large number of board members. In contrast, where there is less uncertainty, discussions involving a large board size can be controlled by a task-focused approach, but can also be enriched by sharing a range of opinions

from a diversified group of board members. This can be tested as follows:

H.7. *Board size is negatively associated with the decision to locate FDI in a complex and uncertain environment, but positively associated with the decision in a simpler location.*

In making strategic decisions, board members play a central role, contributing their personal expertise and contacts to acquire external resources (Daily et al., 1999). However, board involvement in policy-making may be passive and relies on the decisions of the controlling group (Golden and Zajac, 2001; Warther, 1998; Baysinger and Butler, 1985). To encourage directors to be more vigilant about the quality of governance within the firm and be generous with their time and attention, increased shareholding can be an effective incentive (Hambrick and Jackson, 2000; Oswald and Jahera, 1991; Shivdasani and Yermack, 1999). However, the connection between directors' wealth and the value of the firm can also stimulate risk-aversion. Under these assumptions, it is likely that where a potentially risky foreign investment is necessary to develop the future of the firm, those with a higher shareholding will be more likely to select a secured location with a familiar environment. This leads to the following two conflicting hypotheses:

H.8. *The extent of board shareholding is positively associated with FDI location choice in high competitive markets.*

H.9. *The extent of board shareholding is positively associated with FDI location choice in secure markets.*

Methodology

Using the sample of FDI projects undertaken by the 228 firms in this sample, this chapter investigates the corporate governance effect on the spatial distribution of corporate foreign investment. The explanatory variables are a number of corporate governance factors and several contextual variables used as controls, all of which are defined in Chapter 5. The

models are also outlined in that chapter and therefore the explanation here includes the construction of the dependent variables specific to this chapter and also details of the estimating equations.

Dependent Variable

Since there has been a long-standing special historical and political relationship between Taiwan and China, it seems appropriate that the choice of location of FDI projects into China requires a separate examination. Thus, the analysis in this chapter considers location choice in China and elsewhere is a parallel set of regressions. Furthermore, even within China, the analysis is divided into province-specific regions, as in such a large and diverse country, the particular characteristics of the various provinces may influence different kinds of investment decisions.

From the discussion of tax-havens earlier in the chapter, it is clear that this factor needs to be considered, certainly in the estimation of location choice for investment outside China. Tax-haven countries are generally a first option for FDI location and the data used here uses that in Eiteman et al. (1998, pp. 549). Singapore and Hong Kong are frequently seen as tax-haven countries. However, they are very similar to Taiwan in terms of culture, and are located a relatively short distance to both China and Taiwan. Therefore, both countries can be used as a convenient link between Taiwan and China. Further, Southeast Asian countries can attract Taiwanese FDI by both low-cost production and the familiar environment. Therefore, these countries are represented in the estimation by a dummy variable in the specification to denote their particularly importance in Taiwanese FDI location decisions. One additional factor is the group of advanced economies, such as the US, Japan and the EU, which provide consumer markets and production technology for Taiwanese companies. Therefore, a strategic choice based on the acquisition of these attributes is also recognised. In summary, there are five locational categories for Taiwanese FDI in this section including (1)

tax-haven countries, (2) Singapore and Hong Kong, (3) Southeast Asia, (4) Advanced Countries and (5) the rest (base-alternative).

As noted above, the diversity of China demands a region-specific approach, thus the location choices of Taiwanese FDI in China are generalised into six groups that reflect different motivations for FDI. Inland areas of China lag behind in economic development (Chadee et al, 2003). The northern coast (Hebai and Shandong provinces) and middle coastal areas (Jiangsu and Zhejiang provinces) rely on heavy and light industries respectively. Further, business in the middle coastal provinces has traditionally been rooted in Guanxi traditions and also has a strong connection with overseas Chinese communities, including Taiwan. Fujian province on the south coast is where the majority of Taiwanese people originate, sharing a similar culture and identical dialect. Guangdong province is also on the south coast and has a long history of attracting foreign investments, particular from neighbouring Hong Kong. Finally, the metropolitan areas of China (the cities of Beijing, Tianjin and Shanghai) have huge populations, a relatively advanced infrastructure and a considerable multinational business sector that can be both an opportunity and also a challenge for Taiwanese firm. Thus, these six regions are included in the analysis of FDI location choice in China. In summary, the six location categories in China are (1) north coast, (2) middle coast, (3) Fujian province, (4) Guangdow province, (5) metropolitan cities and (6) the rest inland areas (base-alternative).

Correlation Matrices

Tables 8.1 and 8.2 show the correlation matrices for the variables used to model FDI location in China and the rest of the world. As indicated in both tables, the control variables (four investment motives, two sectoral dummies, company age, value of FDI, firm capitalisation, ownership of the investment and annual Taiwanese FDI to China) are strongly correlated with FDI location choices, particularly for those representing motives for investment. On the

other hand, the corporate governance variables (company control status, ownership structure and board characteristics) are weakly correlated with FDI location decisions in China and are neutral with respect to the rest of the world. The low correlations are frequently a result in discrete choice models due to the nature of the dependent variable, since the variance is restricted compared with a series of real values. The implications of this will be included in the later discussion.

Table 8.1 Correlations Matrix for Corporate Governance and FDI Location Decision in China

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26
1. FDI Location in China	1.00																									
2. Total Taiwan FDI in China	-0.06	1.00																								
3. Textiles	0.12**	0.15**	1.00																							
4. Electrics	-0.12**	0.14**	-0.36**	1.00																						
5. Corporate Issued Capital	-0.01	-0.06	0.17**	-0.03	1.00																					
6. Firm Age	0.03	-0.06	0.15**	-0.37**	0.16**	1.00																				
7. Investing Value	0.10*	-0.18**	0.07	-0.12*	0.21**	0.12*	1.00																			
8. Ownership of Investment	-0.08	0.11*	-0.05	0.12**	0.07	-0.06	-0.05	1.00																		
9. Average Wage	-0.16**	0.79**	0.07	0.18**	-0.06	-0.10*	-0.16**	0.16**	1.00																	
10. per capita Consumption	-0.25**	0.76**	0.05	0.21**	-0.07	-0.15**	-0.16**	0.17**	0.97**	1.00																
11. Traffic Length	-0.44**	0.19**	-0.02	0.14**	-0.02	-0.19**	-0.03	0.16**	0.20**	0.28**	1.00															
12. FDI Reception	-0.24**	0.48**	0.03	0.28**	-0.03	-0.23**	-0.07	0.22**	0.60**	0.68**	0.66**	1														
13. State-Controlled Firm	0.07	0.04	0.05	-0.07	0.12*	-0.06	-0.03	-0.18**	0.00	-0.01	-0.05	-0.04	1.00													
14. Foreign-Controlled Firm	0.03	0.11*	-0.09	0.21**	-0.03	0.10*	-0.02	0.08	0.04	0.03	-0.08	-0.01	-0.02	1.00												
15. Family-Controlled Firm	-0.06	-0.11*	0.06	-0.15**	-0.03	-0.07	0.03	0.01	-0.04	-0.02	0.10*	0.02	-0.42**	-0.89**	1.00											
16. Foreign Fund Ownership	-0.15**	-0.05	-0.22**	0.22**	0.29**	-0.04	0.00	0.15**	0.01	0.02	0.06	0.02	-0.05	-0.09	0.10*	1.00										
17. Foreign Banks Ownership	0.03	0.05	-0.10	0.29**	-0.05	-0.04	-0.03	-0.05	0.07	0.06	0.04	0.12**	0.00	-0.01	0.01	0.19**	1.00									
18. Domestic Banks Ownership	0.11*	-0.01	0.08	-0.04	0.18**	0.15**	0.07	-0.02	0.02	0.00	-0.04	0.03	0.02	0.04	-0.05	0.18**	0.01	1.00								
19. Domestic Fund Ownership	-0.12*	0.14**	-0.07	0.49**	-0.19**	-0.26**	-0.09	0.13**	0.18**	0.22**	0.24**	0.33**	-0.06	0.13**	-0.09*	0.10*	0.24	0.12	1.00							
20. Controlling Family Ownership	0.12*	0.07	0.20**	-0.15**	-0.15**	-0.16**	0.06	-0.07	0.01	0.01	0.09	0.09	-0.13**	-0.10*	0.15**	-0.28**	-0.07	-0.06	0.07	1.00						
21. Independent CEO	-0.03	0.04	-0.01	0.09	0.31**	0.18**	0.05	0.10*	0.09	0.05	-0.10*	-0.02	0.06	0.12**	-0.14**	0.15**	0.12**	0.07	-0.17**	-0.43**	1.00					
22. Independent Chairman	0.04	-0.07	-0.05	0.06	0.14**	0.00	-0.02	0.01	-0.10*	-0.11*	-0.08	-0.13**	0.06	0.24**	-0.24**	0.04	0.03	0.09	-0.15**	-0.35**	0.29**	1.00				
23. CEO = Chairman	0.02	0.08	-0.20**	0.19**	-0.19**	-0.05	0.00	0.10*	0.07	0.10*	0.08	0.18**	-0.05	-0.10*	0.12*	-0.01	-0.06	0.05	0.16**	0.16**	-0.43**	-0.19**	1.00			
24. Director Size	-0.04	0.02	0.14**	-0.09	0.39**	0.54**	0.02	-0.04	-0.03	-0.07	-0.11*	-0.19**	0.01	0.11*	-0.10*	0.08	-0.13**	0.19**	-0.26**	-0.39**	0.32**	0.19**	-0.24**	1.00		
25. Supervisor Size	-0.08	0.12*	0.14**	-0.08	0.36**	0.32**	0.05	0.10*	0.06	0.04	-0.06	-0.08	0.07	0.18**	-0.19**	0.17**	-0.16**	0.20**	-0.11*	-0.22**	0.31**	0.30**	-0.16**	0.65**	1.00	
26. %Family Control on Board	0.12**	0.00	0.22**	-0.33**	-0.24**	0.10	0.08	-0.13**	-0.04	-0.06	-0.13**	-0.14**	-0.01	-0.05	0.05	-0.34**	-0.14**	-0.08	-0.15**	0.40**	-0.27**	-0.25**	-0.12*	-0.22**	-0.24**	1.00
27. Boards Shareholding	-0.11*	-0.09	0.10	-0.30**	-0.07	0.23**	-0.01	0.01	-0.07	-0.07	-0.02	-0.08	-0.08	-0.17**	0.19**	0.07	-0.19**	0.11**	-0.11**	-0.20**	-0.10*	-0.19**	0.02	0.07	-0.02	0.16**

Note: ** Correlation is significant at 0.01 level (two-tailed); * Correlation is significant at the 0.05 level (two-tailed).

Table 8.2 Correlation Matrix of Corporate Governance and FDI Location Decision (rest of the world)

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26
1. FDI Location in Overseas	1.00																									
2. Ownership of Investment	0.09*	1.00																								
3. Investing Value	0.14**	0.09*	1.00																							
4. Textiles	0.03	-0.02	0.00	1.00																						
5. Electrics	-0.07	0.00	0.05	-0.39**	1.00																					
6. Corporate Issued Capital	0.04	0.02	0.23**	-0.03	0.06	1.00																				
7. Firm Age	-0.02	-0.03	-0.04	0.08*	-0.44**	-0.07	1.00																			
8. GDP per capita	-0.10*	-0.01	-0.07	-0.06	0.16**	0.06	-0.12**	1.00																		
9. Resource Balance	-0.08*	-0.02	-0.01	0.06	-0.14**	-0.08	0.05	-0.43**	1.00																	
10. Transport Service Export	-0.54**	-0.10**	-0.07	-0.07	0.04	0.06	-0.06	0.19**	0.01	1.00																
11. Tax on Goods & Services	-0.53**	-0.15**	-0.07	0.01	0.03	-0.07	-0.01	-0.47**	0.38**	0.34**	1.00															
12. State-Controlled Firm	0.00	0.06	-0.05	0.01	-0.16**	0.47**	0.06	-0.03	0.03	0.04	-0.04	1.00														
13. Foreign-Controlled Firm	-0.05	-0.10*	0.05	-0.13**	0.38**	0.20**	-0.07	0.05	-0.05	0.05	0.02	-0.08	1.00													
14. Family-Controlled Firm	0.07	0.03	-0.02	0.15**	-0.29**	-0.32**	0.05	-0.01	0.06	-0.06	0.03	-0.26**	-0.57**	1.00												
15. Foreign Fund Ownership	0.00	0.06	0.09*	-0.05	0.18**	0.22**	-0.12**	0.04	-0.03	-0.03	-0.02	-0.02	-0.03	0.00	1.00											
16. Foreign Bank Ownership	0.02	0.00	0.08	-0.06	0.14**	0.07	-0.11*	0.11*	-0.08	-0.03	-0.04	-0.03	-0.03	0.04	-0.01	1.00										
17. Domestic Bank Ownership	-0.06	-0.06	0.05	-0.01	-0.09*	0.15**	0.05	-0.04	0.04	0.18**	0.06	0.15**	0.19**	-0.18**	0.02	-0.07	1.00									
18. Domestic Fund Ownership	0.02	-0.02	-0.04	0.33**	-0.01	-0.06	-0.15**	0.04	0.01	-0.02	-0.02	-0.08	-0.02	0.08	0.16**	-0.05	0.04	1.00								
19. Controlling Family Ownership	0.04	-0.02	-0.05	0.25**	-0.27**	-0.24**	0.08	-0.04	0.07	0.00	0.08	-0.20**	-0.20**	0.49**	-0.07	0.05	-0.06	0.10*	1.00							
20. Independent CEO	-0.07	0.08	0.03	-0.09*	0.21**	-0.05	-0.07	0.02	-0.06	0.05	0.07	-0.03	0.14**	-0.18**	0.01	-0.08*	0.06	-0.07	-0.32**	1.00						
21. Independent Chairman	0.02	0.00	0.12**	-0.02	0.18**	0.19**	0.04	-0.01	-0.06	0.01	-0.04	0.08	0.34**	-0.37**	-0.01	-0.02	0.14**	-0.12**	-0.33**	0.21	1.00					
22. CEO=Chairman	0.08	0.09*	-0.01	-0.07	-0.01	-0.16**	0.03	-0.08	0.03	-0.04	-0.05	-0.08*	-0.18**	0.15**	0.12**	-0.06	-0.09*	-0.07	0.07	-0.35**	-0.12**	1.00				
23. Director Size	-0.07	0.00	0.04	0.03	-0.03	0.24**	0.34**	0.05	-0.07	0.05	-0.03	0.05	0.13**	-0.22**	-0.03	-0.02	0.06	-0.07	-0.25**	0.17**	0.28**	-0.22**	1.00			
24. Supervisor Size	-0.03	0.03	0.07	-0.01	0.03	0.30**	0.10*	0.07	-0.11*	0.00	-0.03	0.11*	0.11*	-0.14**	0.06	0.31**	0.06	-0.01	-0.12**	0.13**	0.27**	-0.22**	0.61**	1.00		
25. % Faily Control on Board	0.06	-0.04	-0.03	0.29**	-0.37**	-0.10*	0.19**	-0.08	0.07	-0.02	0.03	-0.05	-0.14**	0.38**	-0.15**	0.13**	0.03	0.08	0.45**	-0.33**	-0.32**	0.06	-0.22**	-0.16**	1.00	
26. Boards Shareholding	0.04	-0.05	-0.04	0.04	-0.19**	0.14**	-0.03	-0.03	0.10*	0.08*	0.05	0.19**	0.16**	0.06	-0.08	0.02	0.15**	0.04	0.56**	-0.19**	-0.18**	-0.04	-0.12**	-0.05	0.23**	1.00

Notes: ** Correlation is significant at 0.01 level (two-tailed); * Correlation is significant at the 0.05 level (two-tailed).

The Expected Association between Corporate Governance and FDI Location Choice

Amongst the FDI location choices in China, Fujian and Middle Coast are the regions reflecting family links for Taiwanese families. Unlike the middle coast area, Fujian is not popular destination of FDI, so Taiwanese investment will face less competition and subsequently less risk in this location. On the other hand, the three biggest cities and the north coast present more opportunities due to the huge consumer markets, openness and accessible information and potential for development. However, these environments are relatively more complicated for Taiwanese firms. Competition is most likely to be particularly strong in the metropolitan cities and in Guangdow. Table 8.3 indicates the expected impacts of the corporate governance variables on FDI location choices in China, for each of the stated hypotheses.

Table 8.3 The Expected Association between Corporate Governance and FDI Location in China

	Guangdow	Cities	Fujain	M. Coast	N. Coast
Family Controlled Firm	-	H2. Positive	H1. Positive	H1. Positive	H2. Positive
Controlling Family Ownership	-	H2. Positive	H1. Positive	H1. Positive	H2. Positive
Family Control on Board	-	H2. Positive	H1. Positive	H1. Positive	H2. Positive
Institutional Ownerships	-	H4. Positive	-	-	-
Institutional Ownerships	H5. Insig.	H5. Insig.	H5. Insig.	H5. Insig.	H5. Insig.
Independent Chairman	-	H6. Positive	-	-	H6. Positive
Independent CEO	-	H6. Positive	-	-	H6. Positive
Director Number	-	H7. Negative	H7. Positive	-	-
Supervisor Number	-	H7. Negative	H7. Positive	-	-
Board Shareholding	H8. Positive	H8. Positive	H9. Positive	-	-

H1. Family Ownership and Control are positive for Family-Linked Location.
H2. Family Ownership and Control are positive for Advanced Marketed
H3. Family Ownership and Control are positive for Tax-Haven countries.
H4. Institutional Ownership is positive for Advanced Marketed.
H5. Institutional Ownership is insignificant for FDI Location Decision.
H6. Independent Board is positive for Advanced Market.
H7. Big Board Size is negative for Complicated Location but positive for Simple Location.
H8. Board Shareholding is positive for High-Competitive Market.
H9. Board Shareholding is positive for Secure Market.

For FDI locations outside China, Southeast Asian countries provide low-cost production and a similar cultural environment to Taiwan. These therefore present a relatively secure

and straightforward choice for Taiwanese FDI. Also, tax-haven countries provide tax benefits for investors. Moreover, both the option of Singapore / Hong Kong and Southeast Asia reflect a familiar environment for Taiwanese dominant controlling families. In contrast, the developed countries are unfamiliar, complicated and high competitive locations. Table 8.4 indicates the expected impacts of the corporate governance variables on the FDI location choices, for each of the stated hypotheses.

Table 8.4. The Expected Association between Corporate Governance and FDI Location (outside China)

	Sing / HK	S.E. Asia	Developed	Tax-Haven
Family Controlled Firm	H1. Positive	H1. Positive	H2 Positive	H3 Positive
Controlling Family Ownership	H1. Positive	H1. Positive	H2 Positive	H3 Positive
Family Control on Board	H1. Positive	H1. Positive	H2 Positive	H3 Positive
Institutional Ownerships	-	-	H4. Positive	-
Institutional Ownerships	H5. Insig.	H5. Insig.	H5. Insig.	H5. Insig.
Independent Chairman	-	-	H6. Positive	-
Independent CEO	-	-	H6. Positive	-
Director Number	-	H7. Positive	H7. Negative	H7. Positive
Supervisor Number	-	H7. Positive	H7. Negative	H7. Positive
Board Shareholding	-	H9. Positive	H8. Positive	H9. Positive

H1. Family Ownership and Control are positive for Family-Linked Location.
H2. Family Ownership and Control are positive for Advanced Marketed
H3. Family Ownership and Control are positive for Tax-Haven countries.
H4. Institutional Ownership is positive for Advanced Marketed.
H5. Institutional Ownership is insignificant for FDI Location Decision.
H6. Independent Board is positive for Advanced Market.
H7. Big Board Size is negative for Complicated Location but positive for Simple Location.
H8. Board Shareholding is positive for High-Competitive Market.
H9. Board Shareholding is positive for Secure Market.

Binary & Multinomial Logit Model

In the review of the literature, the method of conditional logit devised by McFadden (1974) dominates studies of FDI location choice (for example: Head and Ries, 1996; Ford and Strange, 1999; Chadee et al., 2003; Crozet et al., 2004). However, this study aims to test the influence on choice outcomes from firm level differences in corporate governance, and the conditional logit that is used to capture the effect of location-specific attributes (Greene,

2003), can be inappropriate here. Therefore, multinomial logit is used to address the effect of firm-specific characteristics on discrete choice outcomes. Further, the alternative choices in this study are based on innate differences in FDI location, which should be moderated on the methodological problems arising from the independence of possible alternatives.

The selection of this particular econometric approach is supported by previous empirical studies that model similar sets of alternatives (for example: Hensher, 1986; Terza, 1985; Schmidt and Strauss, 1975a; 1975b; Boskin, 1974). The details of the logit model have been presented in Chapter 5, and thus the primary equation can be specified. The probability that firm, *i*, with characteristics X_i, that include corporate governance characteristics, plus a number of controls, selects a specific location for FDI, given options *J*, chosen from *j*+1 alternatives, can be written.

$$prob(Y_i = J) = \frac{e^{\beta_J X_i}}{\sum_{k=0}^{j} e^{\beta_k X_i}}, J=0,1,...j \qquad \textbf{8.1}$$

For FDI located in China, there are the five stated available options , plus one base-alternative , giving *J=0,1,...,5*. The X_i in the case of FDI in China are: the total value of annual FDI from Taiwan to China, the textile and electrical industry dummies, issued capital, age of firm, the value of all FDI investment, the proportion of ownership in the case of a joint venture, average wage at the FDI location, per capita consumption at the FDI location, transport related infrastructure, the value of FDI inflows to the region in total and a number of the of the corporate governance factors used in the earlier empirical chapters, for example, controlling status, ownership structure and board characteristics.

For FDI location choice in the rest of the world, four options are available, Singapore/Hong Kong, Southeast Asia, Japan/US/EU, and tax-haven countries, plus one base-alternative, giving *J=0,1,...,4*. The Xi in this model are: the proportion of ownership in the case of joint venture, value of investment, the textiles and electrical industry dummies,

issued capital, age of firm, GDP per capita in the FDI location, balance of resources (measured by the country's exports of goods and services minus imports of goods and services), transport service exports (measured by all transport services provided by residents to foreigners), tax on goods and services, and finally, several of the corporate governance factors used in the earlier empirical chapters, such as controlling status, ownership structure and board characteristics.

Further, based on equation 8.1 and the same regressors outlined above, a binomial logit model is estimated for both FDI to China and the rest of the world, where *J=0,1* and 1 is the testing option and 0 otherwise.

Results

Table 8.5 reports the results of the association between ownership by significant shareholders and location choice in the respect to outward FDI of Taiwanese firms to China (the base alternative is not shown). It is clear that apart from domestic banks, which have a significant effect, particularly in Fujian province, the other institutional investors are either unimportant or ambiguous in their influence. These results reveal that foreign institutional investors have little impact, confirming H5 stated above. Importantly, the controlling family has a strong impact on the decision to undertake FDI in Fujian province. This not surprising, as the common cultural and business environment between Fujian and Taiwan and the strong community connections make this a less uncertain setting, and thus H1 is supported. There is also support for the view that the controlling family has a moderate effect in the decision to locate FDI in metropolitan areas. These are the regions of China that are more closely aligned with developed countries, presenting the same opportunities and challenges, thus supporting H2.

Table 8.5 Logit Regression: Association between Ownership and FDI Location Choice (China)

	GUANGDOW		CITY		FUJIAN		MIDDLE Coast		NORTH Coast	
	Bi	Multi	Bi	Multi	Bi	Multi	Bi	Multi	Bi	Multi
Taiwan FDI in China	-0.00**	-0.00***	-0.00†	-0.00**	-0.00	-0.00*	0.00***	-0.00*	0.00**	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Textiles	-0.28	2.33	1.68	2.16	0.49	2.31†	0.50	3.55*	-0.26	0.80
	(0.84)	(1.59)	(2.45)	(2.43)	(0.65)	(1.34)	(0.37)	(1.57)	(0.80)	(1.13)
Electrics	0.18	-2.72	0.45	3.79	-1.15	-1.63	0.04	1.07	-1.39	-1.11
	(0.87)	(1.96)	(2.01)	(2.36)	(0.93)	(1.79)	(0.38)	(1.83)	(1.72)	(1.85)
Corporate Issued Capital	0.00	-0.00†	-0.00	-0.00†	-0.00	-0.00	0.00	-0.00*	0.00	-0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Firm Age	0.06	0.08	0.19	0.26**	0.03	0.18**	-0.03	0.20**	0.02	0.04
	(0.05)	(0.07)	(0.16)	(0.09)	(0.05)	(0.07)	(0.02)	(0.10)	(0.07)	(0.05)
Investing Value	0.00	-0.00	0.00	0.00	-0.00	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Ownership of Investment	0.02†	0.05**	-0.03	0.02	-0.01	0.02	0.01	0.03*	-0.02†	0.01
	(0.01)	(0.02)	(0.03)	(0.02)	(0.01)	(0.01)	(0.00)	(0.02)	(0.01)	(0.02)
Average Wage	-0.00**	0.00*	-0.01*	-0.01†	0.00*	0.00*	0.00**	0.00	0.00†	0.00*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
per capita Consumption	0.00***	0.00	0.02*	0.02**	-0.00**	-0.00	-0.00***	0.00*	-0.01*	-0.01*
	(0.00)	(0.00)	(0.10)	(0.01)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Traffic Length	0.00***	-0.00*	-0.00**	-0.00***	0.00*	-0.00*	-0.00***	-0.00***	0.00*	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
FDI Reception	0.00***	0.00***	0.00†	0.00***	0.00	0.00***	0.00***	0.00***	0.00	0.00**
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Foreign Investing Funds IV	-1.29	0.56	4.34	0.11	1.61*	-0.04	-0.54	0.39	0.58	-0.166
	(0.87)	(0.48)	(3.72)	(0.53)	(0.68)	(0.55)	(0.36)	(0.45)	(0.95)	(0.42)
Foreign Banks IV	0.20	-2.17	-0.03	0.43	-0.62	-0.32	-0.20	-0.35	2.81*	-1.05
	(0.91)	(1.67)	(2.33)	(1.35)	(0.81)	(0.93)	(0.39)	(0.81)	(1.12)	(1.74)
Domestic Banks IV	-0.86	0.13	-10.90†	-0.09	2.51**	0.30	-0.12	0.17	0.55	0.27
	(1.00)	(0.44)	(5.97)	(0.66)	(0.78)	(0.37)	(0.44)	(0.42)	(1.33)	(0.33)
Domestic Investing Funds IV	-0.12	-0.11	-0.25	0.28	0.06	-0.26	-0.02	-0.12	0.11	0.03
	(0.12)	(0.38)	(0.30)	(0.46)	(0.10)	(0.38)	(0.05)	(0.37)	(0.14)	(0.12)
Government Agency	0.23	0.29	-0.88	0.83*	-0.07	0.26	-0.22	0.44	-0.29	0.11
	(0.57)	(0.36)	(1.17)	(0.39)	(0.38)	(0.31)	(0.24)	(0.37)	(0.57)	(0.20)
Normal Corporation	0.00	-0.11*	-0.02	-0.12†	0.00	-0.05	-0.00	-0.07†	0.02*	-0.04
	(0.01)	(0.04)	(0.01)	(0.07)	(0.01)	(0.03)	(0.00)	(0.04)	(0.01)	(0.03)
Controlling Family IV	-0.05	-0.03	0.00	0.14†	0.08**	0.07†	-0.01	0.06	0.06	0.05
	(0.03)	(0.05)	(0.08)	(0.08)	(0.03)	(0.04)	(0.01)	(0.04)	(0.04)	(0.04)
Chi-square	433.87	1152.70	458.97	1152.70	69.37	1152.70	162.98	1152.70	84.58	1152.70
-2 Log likelihood	103.04	-	26.76	-	128.64	-	359.12	-	66.07	-
Cox & Snell R Square	0.62	-	0.64	-	0.14	-	0.31	-	0.17	-
Nagelkerke R Square	0.89	-	0.97	-	0.40	-	0.44	-	0.60	-
Log likelihood	-	-124.19	-	-124.19	-	-124.19	-	-124.19	-	-124.19
Restricted log likelihood	-	-700.54	-	-700.54	-	-700.54	-	-700.54	-	-700.54

Note: Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, *** p<=0.001; Standard Errors in parentheses; IV are instrumental variables.

Table 8.6 Logit Regression: Ownership Factors and FDI Location (rest of the world)

	Sing / HK		S. E. Asia		Japan / US / EU		Tax Haven	
	Bi	Multi	Bi	Multi	Bi	Multi	Bi	Multi
Ownership of Investment	0.02**	0.01	-0.01	0.00	-0.00	-0.01	0.03	0.07***
	(0.01)	(0.01)	(0.00)	(0.01)	(0.01)	(0.01)	(0.02)	(0.01)
Investing Value	-0.00	0.00	-0.00†	0.00	-0.00	0.00	0.00*	0.00*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Textiles	-0.03	-0.33	0.76	0.85	-0.37	-0.22	-0.53	0.28
	(0.43)	(1.00)	(0.80)	(1.11)	(0.64)	(1.03)	(1.10)	(1.07)
Electrics	-0.23	0.64	3.06***	3.82***	0.21	0.50	-1.77†	2.73**
	(0.35)	(0.79)	(0.84)	(1.01)	(0.49)	(0.81)	(0.92)	(0.93)
Corporate Issued Capital	0.00	0.00	-0.00†	-0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Firm Age	0.04*	0.06†	0.13***	0.16***	-0.01	-0.02	-0.13**	0.17***
	(0.15)	(0.03)	(0.04)	(0.04)	(0.02)	(0.03)	(0.04)	(0.03)
GDP per capita	0.00***	0.00*	-0.00***	-0.00***	0.00***	0.00	-0.00***	-0.00***
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Resource Balance	0.00***	0.00	-0.00	-0.00	-0.00†	-0.00	0.00***	0.00*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Transport Service Export	0.04***	-0.02	-0.00	-0.07**	0.08**	0.01	-0.18***	-0.13***
	(0.01)	(0.02)	(0.01)	(0.02)	(0.03)	(0.02)	(0.04)	(0.02)
Tax on Goods & Service	0.05**	-0.15***	0.13***	-0.05	0.23***	-0.13***	-0.90***	-0.38***
	(0.02)	(0.04)	(0.03)	(0.03)	(0.05)	(0.04)	(0.20)	(0.05)
Foreign Investing Funds IV	0.02	-0.06	-0.03	-0.08	0.01	-0.11	0.08	-0.10
	(0.03)	(0.89)	(0.11)	(0.13)	(0.09)	(0.10)	(0.14)	(0.08)
Foreign Banks IV	0.01	0.00	0.14	0.18	-0.09	-0.06	0.05	0.03
	(0.03)	(0.14)	(0.12)	(0.18)	(0.11)	(0.14)	(0.07)	(0.15)
Domestic Banks	-0.04	-0.08	0.01	-0.01	0.01	-0.10	0.07	-0.03
	(0.05)	(0.09)	(0.09)	(0.09)	(0.08)	(0.10)	(0.08)	(0.09)
Domestic Investing Funds IV	-0.05	-0.06	-0.02	0.04	0.03	-0.03	-0.44*	0.02
	(0.04)	(0.07)	(0.09)	(0.09)	(0.05)	(0.06)	(0.20)	(0.08)
Government Agency	-0.01	-0.06†	0.08	0.13†	-0.02	-0.06†	0.01	0.05
	(0.02)	(0.03)	(0.12)	(0.08)	(0.03)	(0.03)	(0.07)	(0.05)
Normal Corporation	0.00	0.02	0.01	0.03	-0.01	0.01	-0.02	0.05*
	(0.01)	(0.02)	(0.02)	(0.03)	(0.01)	(0.02)	(0.02)	(0.02)
Controlling Family IV	-0.02	0.01	-0.00	0.03	0.02	0.02	0.06*	0.06*
	(0.01)	(0.03)	(0.02)	(0.03)	(0.02)	(0.03)	(0.03)	(0.03)
Chi-square	135.42	1004.75	265.69	1004.75	426.35	1004.75	676.37	1004.75
-2 Log likelihood	395.76	-	111.19	-	200.68	-	80.22	-
Cox & Snell R Square	0.22	-	0.38	-	0.53	-	0.70	-
Nagelkerke R Square	0.35	-	0.77	-	0.79	-	0.95	-
Log L	-	-289.37	-	-289.37	-	-289.37	-	-289.37
Pseudo R-squared	-	0.63	-	0.63	-	0.63	-	0.63

Note: Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, *** p<=0.001; Standard Errors in parentheses; IV are instrumental variables.

Table 8.6 reports the results of a similar analysis with respect to FDI located in countries other than China. In this case, none of the institutional investors appear to have a significant effect. This may reflect the conservative role of this group on FDI decisions, again supporting H5. On the other hand, the controlling family are strongly motivated by tax

benefits, when choosing an FDI location. This finding directly validates the argument presented that families wish to transfer corporate wealth from current to future generations, and clearly taking advantage of a tax shelter will facilitate this. However, the analysis does not support the view that the controlling family seeks a familiar environment, as locations such as Singapore, Hong Kong and other South-east Asian countries are not significant factors in the FDI location decision. Equally, no evidence is found for the controlling family to prefer the location of advanced countries, as these were also insignificant.

Table 8.7 Logit Regression: Controlling Status and FDI Location (China)

	GUANGDOW		CITY		FUJIAN		MIDDLE Coast		NORTH Coast	
	Bi	Multi	Bi	Multi	Bi	Multi	Bi	Multi	Bi	Multi
Taiwan FDI in China	-0.00**	-0.00***	-0.00	-0.00**	-0.00	-0.00*	0.00***	-0.00**	0.00**	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Textiles	-0.61	3.02†	0.26	2.89	-0.26	3.00*	0.39	3.39*	0.18	1.82†
	(0.82)	(1.74)	(1.40)	(2.18)	(0.60)	(1.45)	(0.36)	(1.65)	(0.72)	(1.08)
Electrics	0.17	0.07	1.65	5.29*	-1.87*	-0.16	0.08	3.47*	-2.09	-1.10
	(0.80)	(1.76)	(1.34)	(2.23)	(0.91)	(1.63)	(0.38)	(1.77)	(1.48)	(1.69)
Corporate Issued Capital	-0.00	-0.00	-0.00	-0.00	-0.00	-0.00	0.00	-0.00†	-0.00	-0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Firm Age	0.05	0.11	0.02	0.27**	0.01	0.15*	-0.04*	0.19**	-0.04	0.01
	(0.04)	(0.08)	(0.07)	(0.09)	(0.03)	(0.06)	(0.02)	(0.07)	(0.04)	(0.04)
Investing Value	0.00	0.00	0.00	0.00	-0.00	-0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Ownership of Investment	0.02†	0.05**	-0.02	0.02	-0.01	0.02	0.00	0.03†	-0.02*	0.01
	(0.01)	(0.02)	(0.02)	(0.02)	(0.01)	(0.01)	(0.00)	(0.02)	(0.01)	(0.02)
Average Wage	-0.00**	0.00***	-0.00*	-0.00	0.00*	0.00*	0.00**	0.00†	0.00*	0.00*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
per capita Consumption	0.00***	0.00	0.01*	0.01**	-0.00**	-0.00	-0.00***	0.00†	-0.01**	-0.01*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Traffic Length	0.00***	-0.00*	-0.00***	-0.00***	0.00*	-0.00*	-0.00***	-0.00***	0.00**	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
FDI Reception	0.00***	0.00***	0.00	0.00***	0.00	0.00***	0.00***	0.00***	0.00†	0.00**
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
State Controlled	-2.80	3.78	0.16	35.97	3.27†	34.64	0.14	35.06	0.15	30.39
	(25.14)	(116)	(5.80)	(234.5)	(1.97)	(234.5)	(1.30)	(234.5)	(1.95)	(234.5)
Foreign Controlled	-4.66**	-11.84***	0.63	-7.48†	4.79**	-2.65	0.54	-7.53*	-4.42	-30.19
	(1.75)	(3.06)	(2.51)	(3.97)	(1.53)	(2.45)	(0.72)	(3.25)	(27.44)	(849)
Family Controlled	-0.64	-1.89	0.76	3.30†	2.13†	2.36	1.34**	2.77*	0.46	0.42
	(0.74)	(1.23)	(1.42)	(1.92)	(1.26)	(1.47)	(0.43)	(1.34)	(1.00)	(0.93)
Chi-square	436.38	1160.66	443.95	1160.66	56.84	1160.66	169.83	1160.66	70.34	1160.66
-2 Log likelihood	100.53	-	41.78	-	141.17	-	352.27	-	80.32	-
Cox & Snell R Square	0.63	-	0.63	-	0.12	-	0.32	-	0.15	-
Nagelkerke R Square	0.89	-	0.95	-	0.33	-	0.46	-	0.51	-
Log likelihood	-	-120.21	-	-120.21	-	-120.21	-	-120.21	-	-120.21
Restricted log likelihood	-	-700.54	-	-700.54	-	-700.54	-	-700.54	-	-700.54

Note: Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, *** p<=0.001; Standard Errors in parentheses

Table 8.7 above shows the results of modelling the influence of corporate control on FDI location choice in China. Family controlled firms in Taiwan have a significant degree of influence, leading to investment project in the middle coastal region, where local businesses have strong connections with overseas Chinese communities. Family controlled firms also have a significant tendency to invest in Fujian province from where many Taiwanese families originated. Further, the analysis reveals that family-controlled firms are weakly related to the location choice in metropolitan cities. This supports the argument that family control is more likely to generate long-term strategies by investing in areas where there are markets, information, technology and higher levels of competition, such as developed countries and the metropolitan cities in China.

Table 8.8 below shows the results of the influence of corporate controlling status on FDI location choice in the rest of the world. Firms with controlling families have a significant association with the decision to locate FDI in South-east Asia and Singapore and Hong Kong. With close proximity in terms of geography and culture, these environments are very familiar for Taiwanese firms. Thus, the behaviour indicated here support H1. On the other hand, the analysis reveals that family control can also significantly influence FDI in advanced countries including Japan, the US and the EU, supporting the willingness of controlling families to choose a strategy of entry into highly competitive markets. Finally, there is a strong association between family controlled status and investment in tax-haven countries. This finding again supports the argument that motives to transfer corporate control rights to the next generation are paramount.

Table 8.8 Logit Regression: Controlling Status and FDI Location (rest of the world)

	Sing / HK		S.E. Asia		Japan / US / EU		Tax Haven	
	Bi	Multi	Bi	Multi	Bi	Multi	Bi	Multi
Ownership of Investment	0.02**	0.01	-0.01	0.01	-0.00	-0.01	0.037†	0.08***
	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.01)
Investing Value	0.00	0.00	-0.00*	0.00	-0.00†	0.00	0.00*	0.00†
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Textiles	-0.18	0.05	0.68	0.67	-0.09	0.17	-1.80	0.82
	(0.39)	(0.77)	(0.74)	(0.98)	(0.54)	(0.79)	(1.20)	(0.86)
Electrics	-0.02	1.09	2.95***	3.23**	0.30	0.66	-1.11	3.11***
	(0.36)	(0.78)	(0.85)	(1.03)	(0.51)	(0.80)	(0.81)	(0.92)
Corporate Issued Capital	-0.00	-0.00	-0.00†	-0.00	0.00	-0.00	0.00	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Firm Age	0.04**	0.06*	0.13***	0.16***	-0.00	-0.02	-0.11**	0.18***
	(0.01)	(0.03)	(0.04)	(0.04)	(0.02)	(0.03)	(0.04)	(0.03)
GDP per capita	0.00***	0.00	-0.00***	-0.00***	0.00***	0.00***	-0.00***	-0.00***
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Resource Balance	0.00***	0.00	-0.00†	-0.00	-0.00*	-0.00	0.00***	0.00*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Transport Service Export	0.04***	-0.01	0.00	-0.07**	0.08***	0.01	-0.18***	-0.14***
	(0.01)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.04)	(0.02)
Tax on Goods & Service	0.05**	-0.18***	0.13***	-0.09*	0.24***	-0.15***	-0.84***	-0.45***
	(0.02)	(0.04)	(0.03)	(0.04)	(0.05)	(0.04)	(0.17)	(0.06)
State-Controlled Firm	1.02	1.37	-6.72	-27.16	-2.62†	-0.57	-0.03	3.17
	(0.74)	(1.58)	(25.36)	(536.5)	(1.61)	(1.87)	(2.65)	(2.18)
Foreign-Controlled Firm	-0.20	1.01	1.39	3.96**	0.40	0.91	-3.01	2.77*
	(0.47)	(1.03)	(0.92)	(1.38)	(0.68)	(1.04)	(2.04)	(1.35)
Family-Controlled Firm	-0.37	1.18†	0.70	2.99**	0.85	1.12†	1.57†	4.83***
	(0.36)	(0.66)	(0.68)	(0.96)	(0.55)	(0.69)	(0.96)	(0.95)
Chi-square	135.22	1010.60	269.24	1010.60	430.01	1010.60	674.91	1010.60
-2 Log likelihood	395.96	-	107.64	-	197.03	-	81.68	-
Cox & Snell R Square	0.21	-	0.38	-	0.54	-	0.70	-
Nagelkerke R Square	0.35	-	0.78	-	0.80	-	0.95	-
Log L	-	-286.45	-	-286.45	-	-286.45	-	-286.45
Pseudo R-squared	-	0.64	-	0.64	-	0.64	-	0.64

Note: Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, *** p<=0.001; Standard Errors in parentheses.

The final set of estimates result from an examination of the board characteristics of these firms and the impact they may have on FDI location choices. Table 8.9 shows their associations with FDI in China. Independence of board leadership appears not to be important, whereas in contrast, possible interventions by the controlling family board members do influence decisions to invest in the northern coastal regions. Considering that this region is a relatively new area for Taiwanese firms and the fact that it is a heavy industrial area, this can imply that it is attractive for development, again indicating a long-term strategic

plan. Thus, a hypothesis that independence on the board leads firm's to search for potentially highly competitive FDI locations, where they can exploit R&D, compared with non-independence, is rejected.

Table 8.9 Logit Regression: Board Characteristics and FDI Location (China)

	GUANGDOW		CITY		FUJIAN		MIDDLE Coast		NORTH Coast	
	Bi	Multi	Bi	Multi	Bi	Multi	Bi	Multi	Bi	Multi
Taiwan FDI in China	-0.00*	-0.00***	-0.00*	-0.00*	-0.00	-0.00*	0.00***	-0.00*	0.00*	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Textiles	-0.68	3.21†	-1.28	5.56†	-0.01	2.39	0.48	4.45*	-0.12	1.46
	(0.90)	(1.91)	(1.97)	(2.96)	(0.60)	(1.62)	(0.39)	(1.83)	(0.84)	(1.23)
Electrics	-0.14	-1.24	2.76†	2.96	-0.88	-1.65	-0.11	2.40	-0.99	-2.99
	(0.84)	(1.76)	(1.57)	(2.50)	(0.88)	(1.84)	(0.38)	(1.64)	(1.38)	(2.28)
Corporate Issued Capital	0.00	0.00	0.00	-0.00†	0.00	-0.00	-0.00	-0.00†	0.00	-0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Firm Age	0.02	0.19†	0.05	0.55***	0.03	0.23*	-0.04*	0.32**	-0.05	0.02
	(0.04)	(0.10)	(0.08)	(0.16)	(0.03)	(0.10)	(0.02)	(0.11)	(0.05)	(0.07)
Investing Value	0.00	0.00	0.00	0.00	-0.00	-0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Ownership of Investment	0.02†	0.07**	-0.01	-0.00	-0.01	0.01	0.00	0.02	-0.02†	-0.02
	(0.01)	(0.02)	(0.02)	(0.03)	(0.01)	(0.02)	(0.00)	(0.02)	(0.01)	(0.02)
Average Wage	-0.00**	0.01**	-0.01*	-0.01†	0.00	0.00*	0.00**	0.00	0.00*	0.01*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
per capita Consumption	0.00***	-0.00	0.02*	0.03*	-0.00*	-0.00	-0.00***	0.00†	-0.01*	-0.01**
	(0.00)	(0.00)	(0.01)	(0.01)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Traffic Length	0.00***	-0.00†	-0.00**	-0.00***	0.00	-0.00*	-0.00***	-0.00***	0.00*	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
FDI Reception	5.20***	0.00***	0.00†	0.00***	0.00	0.00**	0.00***	0.00***	0.00	0.00**
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Indep. CEO	0.00	-2.36	-0.29	4.87	-0.22	1.21	-0.00	0.65	-0.23	0.02
	(0.11)	(1.61)	(0.28)	(3.90)	(0.28)	(1.47)	(0.05)	(1.61)	(0.26)	(1.35)
Indep. Chairman	-1.18	1.47	0.73	3.79	-0.21	2.26	-0.04	3.69*	-0.92	4.76**
	(1.24)	(1.96)	(1.09)	(2.93)	(0.63)	(1.73)	(0.22)	(1.87)	(1.17)	(1.82)
CEO=Chairman	-0.04	1.92	-0.19	-7.40	-0.06	5.27	0.05	3.77	0.013	1.94
	(0.21)	(4.02)	(0.49)	(7.28)	(0.12)	(3.87)	(0.07)	(4.03)	(0.17)	(3.85)
Director Size	0.04	-0.10	0.39	-0.61†	-0.10	-0.08	-0.06	-0.36	0.10	0.03
	(0.09)	(0.23)	(0.28)	(0.37)	(0.14)	(0.22)	(0.05)	(0.22)	(0.11)	(0.18)
Supervisor Size	-0.04	-1.37	0.34*	-1.23	-0.10	-0.51	-0.06	-0.28	0.02	-1.03
	(0.07)	(1.17)	(0.15)	(1.55)	(0.27)	(0.93)	(0.08)	(1.01)	(0.14)	(0.88)
%Family Control on Board	-0.02	-0.01	-0.04	-0.02	0.01	-0.00	-0.02	0.00	0.01	0.02†
	(0.02)	(0.01)	(0.05)	(0.02)	(0.02)	(0.01)	(0.01)	(0.01)	(0.02)	(0.01)
Boards Shareholding	-0.01	-0.13*	0.08	0.05	0.04*	0.08†	0.00	0.04	0.02	0.04
	(0.03)	(0.06)	(0.07)	(0.09)	(0.02)	(0.05)	(0.01)	(0.05)	(0.03)	(0.04)
Chi-square	431.27	1194.78	451.49	1194.78	54.75	1194.78	161.47	1194.78	75.34	1194.78
-2 Log likelihood	105.64	-	34.25	-	143.26	-	360.63	-	75.32	-
Cox & Snell R Square	0.62	-	0.64	-	0.12	-	0.30	-	0.16	-
Nagelkerke R Square	0.89	-	0.96	-	0.32	-	0.44	-	0.54	-
Log likelihood	-	-103.15		-103.15		-103.15		-103.15		-103.15
Restricted log likelihood	-	-700.54		-700.54		-700.54		-700.54		-700.54

Note: Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, *** p<=0.001; Standard Errors in parentheses.

On the other hand, a larger number of directors on the board do have a significant and negative linkage with the decision to locate FDI in metropolitan cities, curiously contradicted by the impact of a large number of supervisors. In the sample used in this thesis, the average number of directors is eight and of supervisors only 2. Considering this disparity, it is clear that a large board can block FDI in contentious locations, such as highly competitive metropolitan cities in China, and an optimal number of members can enhance decision making is this area. Further, the results indicate that the boards with higher levels of shareholding can significantly influence FDI in Fujian province, which is especially sympathetic to Taiwanese firms. Conversely, firms with a board where shareholding is high, significantly avoid investing in Guangdow province, where Taiwanese firms face competition from Hong Kong. Thus, these results support the hypothesis that board shareholding causes risk-adverse strategies and a reluctance to enter an especially competitive business environment.

Table 8.10 completes these results with the parallel models of FDI location outside China. Here, an independent CEO is positively related to the location of FDI in developed countries. On the other hand, boards that are largely composed of members from the controlling family show a strong tendency to invest in tax-haven countries reflecting the family intention to retain control of the firm for future generations. Interestingly, an independent board chairman acts in a similar way, favouring investments in tax-haven countries. The findings indicate that while board independence potentially encourages the firm to pursue an active FDI strategy, the influence from the controlling family remains the major determinant. This may explain why even an independent chairman still retains the motives of the family. As in the previous set of results, the number of supervisors is significant in achieving FDI in South-east Asia, for the same reasons. Also reflecting the previous discussion, boards with high levels of shareholding are also inclined towards tax-haven countries, reflecting the risk-adverse nature of the board and the benefits of owner wealth maximisation.

Table 8.10 Logit Regression: Board Characteristics and FDI Location (rest of the world)

	Sing / HK		S.E. Asia		Japan / US / EU		Tax Haven	
	Bi	Multi	Bi	Multi	Bi	Multi	Bi	Multi
Ownership of Investment	0.02**	0.01	-0.02*	0.01	-0.00	-0.01	0.03†	0.07***
	(0.01)	(0.01)	(0.01)	(0.02)	(0.01)	(0.01)	(0.02)	(0.01)
Investing Value	-0.00	0.00	-0.00	0.00	-0.00	0.00	0.00***	0.00*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Textiles	-0.23	-0.64	0.70	0.89	-0.17	-0.49	-1.95†	0.18
	(0.39)	(0.82)	(0.86)	(1.08)	(0.58)	(0.83)	(1.16)	(0.97)
Electrics	-0.10	1.22	3.29***	4.31***	0.19	0.77	-1.71*	3.29***
	(0.34)	(0.79)	(0.93)	(1.11)	(0.49)	(0.80)	(0.85)	(0.98)
Corporate Issued Capital	-0.00	-0.00	-0.00†	-0.00**	-0.00	-0.00	0.00	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Firm Age	0.03*	0.05	0.15**	0.16***	-0.00	-0.03	-0.14**	0.12**
	(0.02)	(0.03)	(0.05)	(0.04)	(0.03)	(0.03)	(0.04)	(0.04)
GDP per capita	0.00***	0.00	-0.00***	-0.00***	0.00***	0.00***	-0.00***	-0.00***
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Resource Balance	0.00***	0.00	-0.00†	-0.00	-0.00*	-0.00	0.00***	0.00*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Transport Service Export	0.04***	-0.03	0.01	-0.10***	0.08**	-0.00	-0.16***	-0.17***
	(0.01)	(0.02)	(0.02)	(0.03)	(0.03)	(0.02)	(0.03)	(0.03)
Tax on Goods & Service	0.05*	-0.19***	0.12***	-0.07*	0.24***	-0.15***	-0.73***	-0.49***
	(0.02)	(0.04)	(0.04)	(0.04)	(0.05)	(0.04)	(0.14)	(0.06)
Indep. CEO	-0.55†	-0.62	0.72	-0.85	0.93*	0.05	-0.11	-0.33
	(0.30)	(0.64)	(0.79)	(0.95)	(0.45)	(0.66)	(0.69)	(0.77)
Indep. Chairman	-0.17	-0.49	-1.18	0.03	-0.29	-0.48	1.56†	0.81
	(0.38)	(0.80)	(0.85)	(1.16)	(0.58)	(0.83)	(0.89)	(1.01)
CEO=Chairman	-0.33	-0.53	-0.52	-1.63	0.18	-0.43	0.15	1.06
	(0.42)	(0.82)	(0.79)	(1.12)	(0.63)	(0.87)	(0.88)	(0.99)
Director Size	0.03	0.03	-0.14	-0.23	-0.01	0.04	0.05	0.06
	(0.04)	(0.11)	(0.11)	(0.15)	(0.06)	(0.11)	(0.11)	(0.13)
Supervisor Size	0.16	0.63	0.84†	2.36**	-0.06	0.07	-0.15	1.24*
	(0.18)	(0.50)	(0.56)	(0.73)	(0.30)	(0.51)	(0.42)	(0.56)
%Family Control on Board	-0.00	0.01	0.00	0.01	0.00	0.01	0.02*	0.03***
	(0.00)	(0.01)	(0.01)	(0.01)	(0.00)	(0.01)	(0.01)	(0.01)
Boards Shareholding	-0.01	0.02	-0.01	0.03	0.01	0.03	0.03	0.11***
	(0.01)	(0.03)	(0.02)	(0.04)	(0.02)	(0.03)	(0.03)	(0.03)
Chi-square	138.52	1042.12	270.95	1042.12	428.89	1042.12	674.27	1042.12
-2 Log likelihood	392.66	-	105.93	-	198.14	-	82.31	-
Cox & Snell R Square	0.22	-	0.38	-	0.54	-	0.70	-
Nagelkerke R Square	0.36	-	0.78	-	0.79	-	0.94	-
Log L	-	-270.69	-	-270.69	-	-270.69	-	-270.69
Pseudo R-squared	-	0.66	-	0.66	-	0.66	-	0.66

Note: Level of Significance: † p<=0.10; * p<=0.05, ** p<=0.01, *** p<=0.001; Standard Errors in parentheses.

Discussion and Implications

The Controlling Family

A summary of the tests results in this study related to the controlling families associated with FDI location choice for the Taiwanese firms is in Table 8.11. The hypothesis that controlling

families undertake FDI in areas with cultural and family ties (Fujian and Middle Coast of China and the Southeast Asian countries) is strongly supported. Previous work has argued that overseas Chinese nationals have a preference for investment in the south coast, rather than other areas in China (Chadee et al, 2003; Head and Ries, 1996). This study further verifies the concern that specific historical and cultural connections have led family-controlled firms in Taiwan to favour Fujian and the middle coast provinces, rather than the whole of south-coast China including Guangdow, where local communities have a greater connection with Hong Kong.

Table 8.11 Summary of Associations between Controlling Family and FDI Location

Family Characteristics	Location Choice in China		H.1.	H2.	H3.
Family Control Status	Positive	1. Cities	-	Accepted	-
		2. Middle Coast	Accepted	-	-
		3. Fujian	Accepted	-	-
Family Shareholding	Positive	1. Fujian	Accepted	-	-
		2. Cities	-	Accepted	-
Family Control on Board	Positive	1. North Coast	-	Accepted	-
Family Characteristics	**Location Choice in Overseas**		**H.1.**	**H2.**	**H3.**
Family Control Status	Positive	1. Tax Haven	-	-	Accepted
		2. US / JP / EU	-	Accepted	-
		3. Southeast Asia	Accepted	-	-
Family Shareholding	Positive	1. Tax Haven	-	-	Accepted
Family Control on Board	Positive	1. Tax Haven	-	-	Accepted

H1. Family Ownership and Control are positive for Family-Linked Location.
H2. Family Ownership and Control are positive for Advanced Marketed
H3. Family Ownership and Control are positive for Tax-Haven countries.

Uppsala theory (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlnc, 1977; 1990) suggests that to reduce potential risk, multinational enterprises initially make investments in countries that are geographically and culturally proximate. Based on this argument, controlling families prefer to choose locations that are familiar, reflecting risk aversion that ensures a more certain approach to expansion. However, the influence of controlling families on strategic outcomes is not solely of a conservative nature. The results

in this study show that controlling families can also undertake FDI in advanced markets. Given that advanced markets, such as those in developed countries, and metropolitan cities in China) are generally more competitive, the decision to enter reflects the confidence and ambition of these families to earn some of the surplus gains in the international arena. The findings in this chapter support the view that controlling families do have a long-term strategic vision suggested by James (1999), and construct an FDI portfolio containing both secure and competitive locations.

The analysis also confirms that controlling families are significantly associated with the motive to gain a tax advantage. This finding supports the concerns in the law and economics literature that such a model of ownership and governance can lead to abuse of controlling rights (see Claessens et al., 2000; La Porta et al., 1997; 1998; 2000a). Moreover, the traditional Chinese style family has been found to limit knowledge and experience of FDI to members of the family (Tsang, 2002). Thus, foreign investment can be an efficient indicator that the controlling family has entrenched managerial rights. The preference of the controlling family to invest in tax-havens and or countries with close family contacts, which ensure such information stays within the designated group, is further evidence of the self-interested nature of the family and the impact this may have on strategy decisions related to FDI location.

The Institutional Investors

Table 8.12 summarises the results of the test on the relationship between institutional investors' shareholdings and FDI location choices. As shown in the table, institutional investors do not have a significant input in location choice, supporting the argument that outside block-holders exert a conservative impact on corporate governance (Woidtck, 2002; Faccio and Lasfer, 2000).

Table 8.12 Summary of Associations of Institutional Investor and FDI Location

Institutional Status	**Location Choice in China**	**H4.**	**H5.**
Foreign Investing Fund	Insignificant	Rejected	Accepted
Foreign Bank	Insignificant	Rejected	Accepted
Domestic Bank	Insignificant	Rejected	Accepted
Domestic Investing Fund	Insignificant	Rejected	Accepted
Institutional Status	**Location Choice in Overseas**	**H4.**	**H5.**
Foreign Investing Fund	Insignificant	Rejected	Accepted
Foreign Bank	Insignificant	Rejected	Accepted
Domestic Bank	Insignificant	Rejected	Accepted
Domestic Investing Fund	Insignificant	Rejected	Accepted

H4. Institutional Ownership is positive for Advanced Marketed.
H5. Institutional Ownership is insignificant for FDI Location Decision.

The insignificance of the coefficient on financial institutions can be explained by their risk-adverse nature and a reluctance to support foreign expansion, but also that these institutions may have little input into firm strategy in Taiwan. Although the previous chapters have revealed that institutional investors have an ownership share in firms that are performing above average, and that these firms are the ones more likely to consider FDI, there is nothing to suggest that the decision to select a particular investment location was affected by outside influences. The outside institutional investors may play a role in disciplining the firm, or attempt to pressure the firm towards a particular strategy. However, to participate in detailed decisions to realize strategic value, such as the selection of an optimal FDI location, a high level of understanding of the management style, the structure of internal hierarchies and the cultural background is required, and this can efficiently block any input from neutral outsiders. The finding here reveals the importance of strategic alignment in achieving good governance by outside block-holders, as found in Kroszner and Strahan (2001), La Porta et al (2000a) and Short (1994), but also their inability to participate in detail decisions made at the firm level.

The Board Characteristics

Table 8.13 summarise the results of the analysis related to the associations of board characteristics and FDI location decisions. The analysis in this study does not support the view that board independence encourages ambitious expansion, with respect to FDI located in advanced countries. The finding indicates the relative governance functions of independents, argued by Brickley et al. (1994) and Xie et al. (2003), has limited significance in the decision on FDI location. On the other hand, the model proposed by Warther (1998) that demonstrated that outsider directors tend to compromise with corporate controllers to ensure a continuance of their personal position is verified in this case of Taiwan.

Compared with the independence issue, this study verifies that board size is strongly linked with the FDI location decisions, supporting the arguments about the pivotal role this plays in corporate governance (Daily et al, 1999; Shivdasani and Yermack, 1999). In particular, a board with many members tends to reverse FDI decisions, where these are directed at complex and competitive environments, but to agree to expansion in relatively unsophisticated markets. A large number of supervisors can result in support for FDI in highly competitive markets associated with the metropolitan areas of China, although the number of supervisors is in fact very much lower than that of directors. This finding reveals that communication inefficiency may be a concern in a large management teams (Cho et al, 1994; Priem, 1990).

Further, the results reveal that the proportion of total shareholding owned by board members has a significantly positive influence on FDI location choice, where tax benefits can be achieved and indeed serves as a motivation for further participation in strategic decisions (Shivdasani and Yermack, 1999; Oswald and Jahera, 1991). However, this finding rejects the hypothesis that higher levels of financial alignment between board members and the value of the firm reflects active involvement in corporate governance (Hambrick and Jackson, 2000; Baysinger and Hoskisson, 1990) and encourages ambitious expansion into advanced markets. By contrast, the preference of a high-shareholding board for tax-havens confirms that owners

have an incentive to increase the value of the firm without taking undue risks. This relationship is similar with the controlling family, indicating that where there are high levels of shareholding by board members, the likelihood of board independence is small. Thus, the strategic decisions of the board reflect self-interest on the part of the controller, rather than any motive of using sound governance as a means of providing discipline within the firm.

Table 8.13 Summary of Association of Board Characteristic and FDI Location

Board Characteristics	Location Choice in China		H6.	H7.	H8.	H9.
Independent CEO	Insignificant		Rejected	-	-	-
Independent Chairman	Positive	1. North Coast	Accepted	-	-	-
		2. Middle Coast	Rejected	-	-	-
CEO also Chairman	Insignificant		Rejected	-	-	-
Directors Size	Negative	1. Cities	-	Accepted	-	-
Supervisor Size	Positive	1. Cities	-	Rejected	-	-
Board Shareholding	Positive	1. Fujian	-	-	Rejected	Accepted
	Negative	1. Guangdow	-	-	Rejected	Accepted
Board Characteristics	**Location Choice in Overseas**		**H6.**	**H7.**	**H8.**	**H9.**
Independent CEO	Insignificant		Rejected	-	-	-
Independent Chairman	Insignificant		Rejected	-	-	-
CEO also Chairman	Insignificant		Rejected	-	-	-
Directors Size	Insignificant		-	Rejected	-	-
Supervisor Size	Positive	1. Southeast Asia	-	Accepted	-	-
		2. Tax Haven	-	Accepted	-	-
Board Shareholding	Positive	1. Tax Haven	-	-	Rejected	Accepted

H6. Independent Board is positive for Advanced Market.
H7. Big Board Size is negative for Complicated Location but positive for Simple Location.
H8. Board Shareholding is positive for High-Competitive Market.
H9. Board Shareholding is positive for Secure Market.

Conclusion

The previous chapter confirmed that corporate governance factors can be significantly related to the decision to undertake FDI. In this chapter, the same corporate governance factors are examined with respect to the choice of location for FDI. The results show that in many cases, the model of corporate governance within the firm does have significant association with the spatial distribution of FDI. In particular, the existence of a controlling family tends to achieve a long-term vision of FDI as a firm strategy, focusing the distribution of investment

to secure, competitive markets and also tax havens. However, the associations also suggest the self-interest motive of controlling families and this may result in managerial entrenchment. On the other hand, institutional investors are unimportant in decisions at this level. Finally, board independence is insignificant, although the number of board members and their respective shareholding can determine the outcome.

Conclusions

This thesis has examined well-established theories of corporate governance and the impact of agency conflicts that can arise from owner-manager separation in an entirely new manner. There are two major differences: the national and cultural context of the business community and the type of decision outcomes considered. The context is unique in this kind of study. The sample uses the total population of non-financial firms listed on the Taiwan Stock Exchange, a very large proportion of which are owned and controlled by a dominant family. Thus, business in conducted within traditions that retain the hierarchical system that reflects the power structure of Chinese families and organisations and also reflects the Confucian and Guanxi culture that is enshrined in the vast majority of the Taiwanese people. The second major contribution is to link the theory and practice of corporate governance with the international business literature. This allows a study of the initial motivation and the location of to the ownership and control mechanisms that exist within these firms. Finally, much of the analysis takes account of the particular historical, political and economic relationship between Taiwan and China by separating strategic decision outcomes into two distinct sets of estimates. The results of the empirical analysis highlight the differences between the international relationships within these two separate geographical groups.

A sample of publicly listed, family owned firms in Taiwan provides the opportunity to investigate the "principal-principal" relationship in corporate governance, which is far removed from the Berle-Means (1932) and Jensen and Meckling (1976) models. Interesting effects are found where incentives are not purely personal and motivation is prompted by inter-generational wealth transfers. However, the existing western models may not transfer easily to East Asia. There is evidence that corporate governance systems are crucial and have an influence on the economic competitiveness of nations and companies (Mitton, 2002; Claessens et al., 2000), although none have examined directly the effect of the most important

features of family control on performance or internationalisation outcomes. This thesis contributes to the literature by investigating the effects of the controlling family on the way strategic decisions are made and the implications of these to the firm.

The fundamental argument of this thesis is that while controlling families are assumed to abuse the power invested in them, the resources provided by the family are important to sustain the development of firms in Taiwan. From the perspective of a resource based view of the firm, the argument favours the system of family control rather than find this a weakness as in the Anglo-American context. However, these firms depend on foreign expansion to maintain competitiveness and to grow in a market that is generally mature. The decision to invest abroad is a critical one and the effectiveness of communication, the different objective functions of shareholders and the degree of risk aversion all impact how the decision is made. Previous findings of the corporate governance effect on various strategy decisions, including mergers and acquisitions and diversification have excluded decisions on expansion by strategic foreign investment. Thus, this thesis explores this area of international operations, through this sample of firms in Taiwan.

Dunning's Eclectic Paradigm was the foundation of much of the analysis on internationalisation, although the different historical and cultural context provided some alternative conclusions from the empirical work on developed industrial nations. The ownership advantages and attractiveness of investment location is clearly significant in achieving a strategic outcome. But an additional aspect of this study is the separation of China from the rest of the world when decisions about location are concerned. The familiarity of similar markets is obvious, but so too are tax havens and countries perceived as a link between domestic and overseas operations.

This thesis has revealed specific characteristics of corporate governance in Taiwan that have a significant effect on corporate performance and the strategic positioning of these firms, both domestically and internationally. The remaining sections in this chapter briefly

summarise the approach and the major findings, discuss the limitations and suggest future research.

Summary and Major Findings

The first chapter reviewed the economic development and the commercial environment of Taiwan. This is important, since Taiwan is an emerging economy with a relatively short history of liberalised capital markets, which is a departure from the previous studies of this sort. The establishment and subsequent reform and deregulation of the TSE was reviewed, as well as the cultural traditions and family hierarchical structure that have such an influence on the approach to commerce in Taiwan. This highlights the differences in the systems of discipline in the marketplace and places a contextual outline for an examination of corporate governance.

This chapter also provides the starting point for further discussions on the internationalisation of Taiwanese firms. Trade has been highly important in the nation's growth and export promotion policies have been in place since the 1960s. This has now moved to a strategy of foreign investment and the extent of FDI has increased rapidly since the late 1980s, mainly to gain access to low cost production and also to provide a direct service for customers in overseas markets. Thus, the decision to undertake FDI reflects the strategic decisions of the firm and the way these are formulated is influenced by the characteristics of the board of directors and the power of the dominant family.

The next chapter described the institutional aspects of the system of corporate governance in Taiwan and made some international comparisons. It began by describing the framework of legal structures that are drawn from both company law and securities and exchange law. An important focus of this discussion was to clarify the organisational model, that is, the two-tier board structure with a board of directors and individual supervisors. However, while this places Taiwan in the same grouping as Japan, France and Germany, there

are also major differences, many of which are unique to Taiwan and inform much of the analysis in this thesis. Perhaps the most important feature of the security and exchange law is the stipulation that directors and supervisors hold a given proportion of shares, which is a function of the market capitalisation of the firm. Thus, there is no possibility that any director or supervisor is independent and purely objective.

Chapters Three and Four reviewed the literatures on corporate governance and international business, since the empirical chapters rely on this as well as creating linkages between them. In Chapter Three, the established theory was found to be an excellent starting point, although the East Asian environment was noted and caution injected where appropriate. However, conflict between stakeholders can arise whether this is in a principal and agent framework or a principal-principal one. The empirical research does not appear to be limited to western economies, both those with insider and outsider traditions of governance, but there is little in a system of family controlled but listed firms. This chapter also considered some of the methodological debates emanating from this literature.

Chapter Four reviewed the literature on multinational business, beginning with classical and neoclassical theories of international trade. This was followed by the proposed explanations of the motives for multinational operations and was set within internalisation theory, the resource base view, the Uppsala model and the eclectic paradigm. The chapter continued by reviewing strategic decision models and particularly stressed the influence of corporate governance in the determination of decision outcomes. The internal governance dilemmas of multinational enterprises were also introduced to provide a conceptual link between corporate governance characteristics and internationalisation. Finally, two empirical topics on this link are proposed, which are examined in the later chapters of the thesis.

Chapter Five described the data and the estimation approach. All the information used in the thesis was from secondary sources, the vast majority from the Taiwan Stock Exchange and from annual reports and accounts of the companies. Series that were constructed were

explained, assumptions set out and any manipulation and transformation that was necessary were discussed. The econometric methods used for estimation were specified and justified, which was particularly important as the research questions in all three empirical chapters were different and a range of approaches was required to match the hypotheses tested to an appropriate model. This chapter also considered any likely problems. Endogeneity is potentially the most damaging and methods for testing and dealing with this where discussed in detail. Instrumental variables were used where necessary and were subsequently indicated in the tables of results where used.

The next three chapters are the major empirical parts of the thesis investigating how corporate governance issues relate to firm performance and FDI decisions. Given the particular context of Taiwan, the emphases of these empirical chapters are on the principal-principal relationship between the controlling family and the remaining shareholders. As indicated in Table 9.1, ownership by a controlling family enhances corporate performance of Taiwanese firms. In addition, family-controlled firms in Taiwan significantly outperform firms with more diffuse ownership. Thus, where financial resources are provided by the controlling family, discipline comes from within the firm, rather than an external pressure from the market. This is contrary to the arguments of Claessens et al (2000) and La Porta et al (1997, 1998 and 2000a) and supports the suggestion that resources provided by the controlling family is important for companies in an emerging country like Taiwan.

Table 9.1 Summary Results for the Associations of Controlling Family

Associations with:	Performance	FDI Decisions		FDI Location			
		China	Overseas	China	Locations	Overseas	Locations
Controlling Family							
Family Control Status	Positive	Positive	Positive	Positive	1. Cities 2. Middle Coast	Positive	1. Tax Haven 2. US / JP / EU 3. Southeast Asia
Family Shareholding	Insignificant	Positive	Insignificant	Positive	1. Fujian 2. Cities	Positive	1. Tax Haven
Family Control on Board	Negative	Negative	Negative	Positive	1. North Coast	Positive	1 Tax Haven

Moreover, ownership by a controlling family increased the likelihood that Taiwanese firms undertake FDI, possibly because of self-interest and the need to increase the size of the firm for future generations. This further supports the resource-base perspective, which is entirely expected in Taiwan where the family is the major provider of funds, even for listed firms. With respect to the FDI location decision, the parallel estimations model FDI in China and elsewhere and found the controlling family is significantly related to FDI spatial distribution outcomes. Particularly, when it comes to foreign market choices, familiarity is crucial and thus locations with similar culture and traditions were found to be very attractive for controlling families as a less risky venture. Meanwhile, the controlling family encourages ambitious expansion in the advanced markets in an attempt to earn some of surplus gains in the highly-competitive arena. This reflects a long-term vision on corporate development to expand in both secure and risky markets.

However, consolidating their foreign expansions by investing where extended family networks can provide local support may be beneficial to the family, but also exacerbates the potential for self-interest and is detrimental to minority shareholders. Apart from family ties, tax-havens were found to be attractive locations, confirming the results reported by Tsang (2002) that Chinese family businesses tend to keep knowledge and networks gained through overseas operations within the family.

The results of this thesis also confirm that where the board is dominated by the controlling family, the interests of minority shareholders are often ignored. This validates the principal-principal agency problem and supports the suggestion that this can lead to an abuse of managerial power, in the spirit of Morck et al (1988) and Smith and Amoako-Adu (1999). Perhaps surprisingly, family control over the board can lessen the probability that firms expand by international investment. This responds to the existing literature that owners in senior positions tend to be conservative and hesitate to change current strategy to respond to new and competitive environments (see Rutledge & Karim, 1999; Harrison & Harrell, 1994;

Harrell & Harrison, 1993).

Table 9.2 summaries the results of the association of ownership by institutional investors with firm performance and FDI decisions. While previous research (for example: Maug, 1998; Pound, 1988; Short, 1994) present ambiguous effects between institutional investors and firm performance, this thesis confirms a positive relationship. In this sample, the institutions provided an effective antidote to the principal-principal agency problems within family-controlled firms. On the other hand, ownership by institutional investors influences FDI decisions, although in opposing directions, depending on the country of origin. In this study, domestic institutions were found to favour FDI while foreign institutions did not. This poses a dilemma, as in much of the work on corporate governance, the institutions are found to lessen the impact of agency conflicts. An explanation can be found if the involvement by foreign institutional investors in Taiwanese firm can be seen as an international venture in its own right and further foreign risk is not welcome. Domestic institutions, however, may be willing to undertake overseas investment, and are familiar with the firm undertaking it. Therefore, if the firm is performing well, and needs to expand in a market that provides opportunities, they are supportive of FDI.

Table 9.2 Summary Results for the Associations of Institutional Investor

Associations with:	Performance	FDI Decisions		FDI Location	
		China	Overseas	China	Overseas
Institutional Investor					
Foreign Investing Fund	Positive	Insignificant	Insignificant	Insignificant	Insignificant
Foreign Bank	Positive	Negative	Insignificant	Insignificant	Insignificant
Domestic Bank	Insignificant	Insignificant	Positive	Insignificant	Insignificant
Domestic Investing Fund	Positive	Positive	Positive	Insignificant	Insignificant

In a departure from the findings in the previous chapters, the institutional investors played no role in location choice of FDI. This reflects a distancing of neutral stakeholders from the coalition of control where strategic decisions are concerned. Within the corporate

governance literature, the effect of institutional investors is debated at length. However, in this particularly circumstance, these block shareholders choose to invest in firms that are both diversified internationally or largely domestic, but do not influence the decision about the location of that investment.

As indicated in Table 9.3, the results of this thesis also show that some board characteristics can be significantly related to their performance and foreign investment decisions. Specifically, the number of directors can be a negative aspect of board structure associated with firm value, although the proportion of total equity owned by this group appeared to ensure good performance.

Table 9.3 Summary Results for the Associations of Institutional Investor

Associations with:	Performance	FDI Decisions		FDI Location			
		China	Overseas	China	Locations	Overseas	Locations
Board Characteristics							
Independent CEO	-	Negative	Insignificant	Insignificant	-	Insignificant	-
Independent Chairman	Insignificant	Insignificant	Negative	Positive	1. North Coast 2. Middle Coast	Insignificant	-
CEO also Chairman	Insignificant	Negative	Insignificant	Insignificant	-	Insignificant	-
Total Board Size	Negative	-	-	-	-	-	-
Directors Size	-	Insignificant	Negative	Negative	1. Cities	Insignificant	-
Supervisor Size	-	Insignificant	Positive	Insignificant	-	Positive	1. SE. Asia 2. Tax Haven
Board Shareholding	Positive	Insignificant	-	Positive Negative	1. Fujian 1. Guangdow	Positive	1. Tax Haven

Board characteristics can be linked to FDI decisions too, with the most significant association being the size of the board. Evidence from this sample suggests that the greater the number of supervisors, the higher the possibility they favour FDI, unless the expansion is to China. In this case, greater numbers of directors are associated with the decision not to expand into China. Moreover, this thesis found that board independence has a significant association with FDI location decisions. This finding contradicts previous research on the positive aspects of independence as a benefit to corporate governance, such as Brickley et al (1994) and Xie et al (2003).

On the other hand, the higher level of shareholding held by board members, the more attractive were the tax-haven countries. This indicates a high shareholding board is risk-adverse and less independent from the controlling family. Finally, the analysis result supports the view that that board size determines the effectiveness of decision-making (see Daily et al, 1999 and Shivdasami and Yermack, 1999). A large number of directors facilitated decision-making in uncomplicated environments but hindered where markets are advanced and highly competitive. The contrary effect occurs with respect to supervisors. Considering the numbers of directors are much higher than supervisor' in the firms in this sample, the finding suggests a moderate board size can be optimal for Taiwanese firms with respect to the implementation of corporate governance.

Limitations

Initially, it must be acknowledged that any investigation of corporate governance in Taiwan presents potential criticism about the unsuitability of exporting western theory to other countries where it may not be appropriate. The market for corporate control is underdeveloped and rarely considered in most newly emerging economies. Given the relatively brief history of listed firms in Taiwan, the founding family still firmly controls managerial rights. It is true that enterprise is encouraged and there is not the legacy of state control of the factors of production as is the case in many European and African countries. There are numerous small and medium sized companies operating within a sound legal structure such that a stable economic business community can thrive.

There are limitations relating to the sample. Firstly, compared with other corporate governance studies, the relatively small sample can be a weakness, although it does include the entire population of non-financial firms listed on the TSE in 1995, and unfortunately this is a common constraint in emerging markets research. During the period that this thesis was written, the economy has been dramatically transformed and the financial markets have

expanded considerably as a consequence. The number of listed firms is now close to 700. The distribution across sectors has also changed and there is now a much greater concentration of electrical firms, mainly in the information, computer and semiconductor classifications. Further research will reflect these changes.

Second, much of the corporate governance data was restricted to a single year. Therefore, despite many variables being available in a panel data format, this imbalance meant that the analysis was conducted using mean values. Therefore, as well as not being able to take advantage of the increased sample size and improved estimation results achieved from panel data, it was also difficult to construct instrumental variables where endogeneity was found to be a problem. In particularly, the intuition is that sound corporate governance is causally prior to performance. Unfortunately, it was not possible to formally test this.

An implication of this is that it was only possible to construct the ownership series for one year, and thus it was assumed that the structure of ownership was constant over the whole period of the study. However, this is not such as problem here as it might be in other countries. Taiwanese banks accept equity as collateral for loans and as a result, unless the firm is in very serious danger of making huge loses or actually failing, the controlling managers have no reason to part with their shareholding. Indeed, if the prospects for the firm were so dire, it would be difficult to find a buyer for such shares and liquidity would be a problem. The data from the SFC shows that 30% of insider shareholding has been collateralised, with the level of collateral highly correlated with gearing ratios. This indicates the prevalence of equity collateral among corporate insiders and reduces the concern that liquidity reasons are likely to cause changes in the ownership structure of firms. Thus, although Denis & Sarin (1999) find that ownership and board structure of listed firms on the New York Stock Exchange change substantially over the course of a year, the changes are minor in Taiwan. This reduces any flaws associated with causality or the use of instruments in the econometrics.

The FDI data is also limited. It was not possible to identify FDI before 1999, whereas decisions relating to that investment, including locations issues, were clearly made before that. FDI is a long-term strategy and may have been part of the companies development plan for some time. But, since Taiwan was traditionally a purely inward FDI country for a long time, the decision to undertake outward FDI is a relatively recent one. It seems reasonable to assume that the attempts to introduce an effective system of corporate governance preceded the period of overseas development and there corporate governance influences should slightly lag FDI decisions.

Future Research

This study has focussed on large, publicly-listed, non-financial firms. However, the majority of businesses in Taiwan are small and medium sized firms, which in general, are exclusively family owned. Future research should be conducted in this sector, to identify how strategic decisions are generated when there are no external influences.

A second neglected area is the financial institutions, many of which are known to be highly inefficient. According to the statistics published by the Ministry of Finance, bad debts in Taiwanese banks reached 8.28% in the second quarter of 2002. It has been predicted that the poor performance of this sector is likely to result in a financial crisis in Taiwan, similar to that in Thailand in 1997 (July, 2001, Times). Under these circumstances, a study of the performance and efficiency of the sector, and the role of corporate governance, would provide valuable research that would inform policy on reform and improved bank practice.

The results of this thesis consistently indicate that state ownership and control has a positive impact on governance practice. The number of state-controlled firms is relatively small in Taiwan, and they are usually large-scale monopolies such as telecommunications, steel and certain civil industries. A study on the process and effectiveness of decision-making in a sample of such organisations could be interesting.

Finally, this thesis has examined links between corporate governance and firm performance and corporate governance and FDI. However, the relationship between the internationalisation of firms and corporate performance is still ambiguous. To study the simultaneous effects from the triangle of corporate governance, firm performance and internationalisation, a future study may be conducted to investigate how foreign expansion on the part of firms in Taiwan impacts on domestic performance, or indeed, how domestic performance affects internationalisation.

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